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N^o 14
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NATHALIE BERGER

ON EUROPEAN PENSIONS

INTERVIEW BY **SARAH COLLINS**

One of the main risks for the insurance industry is very low interest rates. How are you tackling that at EU level?

‘We are taking some measures to better allow insurers to face the risks and be able to invest in financial products with a higher yield. We are proceeding with adaptations of the risk charges relating to insurers’ investments. We have already done some incentivisation of investments in European Long-Term Investment Funds (ELTIFs), in infrastructure projects. We are working on infrastructure corporates. And we’re following the negotiations on the regulation on simple, transparent and standardised (STS) securitisation. Once there is political agreement, we will proceed with further adaptations of the capital charges. On infrastructure corporates, we hope to be able to deliver this in the coming months possibly by mid-2017.’

Are there systemically important insurance companies, like banks, which need closer scrutiny?

‘In the last few years, you saw a near-failure in the US of AIG, which raised the issue of whether insurance failures could be of a systemic nature. There is a list,

which is published at global level, and within this list you can see a number of European insurers. There is a methodology for the designation of GSIs (global systemically important insurers) which was produced by the IAIS (International Association of Insurance Supervisors) and was revised last year. We had some concerns with this revised methodology. It will have to be revised, latest for 2019, but we really hope that some improvements could be brought into this list before that date, notably on issues as important as disclosure and transparency, methodology, the quantitative and qualitative phases. It would be good to have a bit more light on this.’

How can you make Europe a global insurance market leader?

‘I think we are a global leader. We have a prudential framework which is the most sophisticated in the world - very advanced, risk-based. Our objective is to produce a regulatory framework which offers our insurers a level playing field in Europe. And we also strive to obtain a level playing field on a worldwide basis. A bilateral agreement on prudential measures

was found with the Americans in early January on insurance, reinsurance and exchange of information between supervisors. We obtained a commitment to remove the requirement for collateral imposed on European reinsurers active in US. We are very vigilant that our insurers and our reinsurers are not subject to any type of discriminatory treatment. And we of course hope that this agreement will effectively be implemented.’

Will the ultimate forward rate (UFR) be lowered in future?

‘We have asked **EIOPA** to do some further work and to really assess the impact of a change of UFR on the market. They will be debating the issue in March. We will examine the data that they have collected. We need to be able to demonstrate that there is really added value and what will be the impact of this change.’

What’s next for pensions, now that the revised directive on Institutions for Occupational Retirement Provision (IORP2) has been adopted?

‘It just entered into force, and member states are to proceed with

“

The problem is that this profession is not regulated.

NATHALIE BERGER is
Head of Unit, Insurance
and Pensions at the DG
FISMA of the European
Commission

the transposition now. We will be working on the establishment of a high-level group on IORP2, we will organise transposition workshops with the member states. We are also looking into the third pillar, which is personal pensions, which are severely under-developed in the EU.

We are working on a legislative initiative. We have commissioned a study to examine the tax dimension and to look into the feasibility of an initiative. We are waiting the final results of the study for end-March, and so we hope that, on this basis, we will be able to make a proposal for a solid framework for EU private pensions. The ambition would be to do this around the CMU [Capital Markets Union] mid-term review - around the summer?

How do you see the changing role of actuaries within insurance companies, and do you plan to give special recognition to the CERA diploma for risk management?

‘I view and value their role as being extremely important. The actuarial function is being formally recognised in legislation. They are called on to play a very important role in ensuring the healthy functioning and operation of insurance undertakings and pension funds. The problem is that this profession is not regulated. It’s only regulated in a number of member states. To get recognition at EU level, recognition at national level is needed. That’s step one.’ ●



MANAGING THE RISKS OF POPULATION DECLINE

BY **PHILIP BOOTH**

Over the years, advanced economies have developed systems of retirement provision that are remarkably prone to systemic risk. Some economists and actuaries have been making this point for a couple of decades and calling for radical reform. Whilst reform is still welcome, we must also try to reduce the impacts of the risks as they materialise.

WE NEED MORE CHILDREN

Pensions systems based on pay-as-you-go principles are not only unstable as populations age and birth rates decline, the risks have self-reinforcing tendencies. As the tax base necessary to finance pensions shrinks, the pressure in the electorate not to cut benefits to older people increases because older voters are more numerous. In order to bring such systems back into balance, we need more children.

SAVE MORE OR POSTPONE RETIREMENT

However, families become ever-more constrained from having more children as net incomes fall due to higher taxes. On average in the EU, taxes paid by the employer and employee sum to a total equal to nearly 70 per cent of take-home wages for low paid workers. On the other hand, in funded systems, not only does funding encourage a more capital intensive economy and the accumulation of property rights over the investments used to fund the pensions, risks are self-

correcting. As longevity increases, annuities become more expensive, thus encouraging people to save more or postpone retirement or combine work with partial retirement.

INWARD MIGRATION

It is difficult to know what will happen over the next forty years, as population decline sets in. Germany's population is projected to fall by 11 million in less than 50 years with nearly all of this fall concentrated within the working population. This is even after allowing for inward migration. Countries such as Portugal, Poland, Slovakia and Croatia are projected to see population falls of up to a quarter within the lifetime of today's forty-year-olds.

PAY-AS-YOU-GO SYSTEMS

If the debate about funding pensions had gone in a different direction a generation ago, we would not be here. But, we are here, so what should we do? A range of policies can help reduce the risks we face. It seems

inexplicable that there are strong political movements in some countries in Europe to lower state pension ages or reverse earlier reforms. Instead, there should be as much movement in the other direction as is politically feasible. Raising state pension ages normally meets fewer political objections than cutting pension levels because those who have already retired are content. State pensions can be linked to the tax base or state pension ages linked to longevity. Pay-as-you-go systems can be phased out for the young, but that will do nothing to avert the coming crisis.

HIGHER SAVINGS

In the light of reform that raises pension ages and perhaps squeezes benefits, the traditional response is to assume that people should make private pension provision. Indeed, the EU institutions have often encouraged such a policy. As it happens, more private pension provision does not necessarily lead to higher savings in aggregate – though the

Philip Booth is an actuary and Professor of Finance, Public Policy and Ethics, St. Mary's University, Twickenham and Senior Academic Fellow, [Institute of Economic Affairs](#).

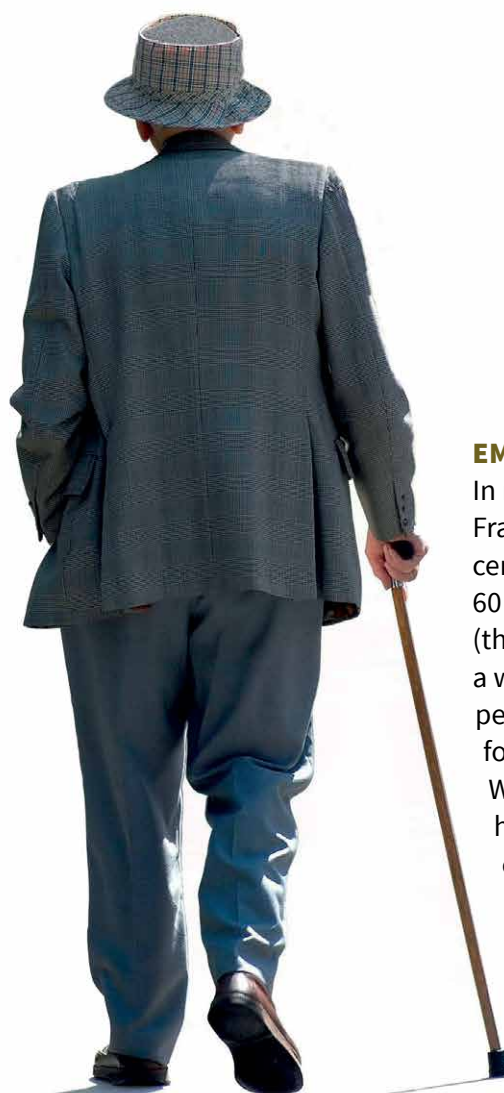
evidence from Chile firmly shows that pension reform led to higher savings, higher investment and higher economic growth.

DISTORT THE PICTURE

Measuring household savings is a nightmare. There are problems such as should we count capital gains and other increases in the value of assets as saving? When people receive a pension, is this dis-saving? Should we include spending out of saving on consumer goods and cars only as dis-saving as the goods depreciate or when the items are bought? These are not small issues, but can distort the picture hugely. Nevertheless, it is notable that countries such as Germany, France and Switzerland in the period 1995-2007 had savings ratios of over 15 per cent whilst the ratio in the UK was less than 5 per cent.

SHOCKING

In a sense, this is encouraging. Even countries with relatively little formal private pension provision have high savings. Higher levels of saving can reduce the pain of increasing the state pension age as people can bridge the gap between their desired retirement time and the time at which they receive their pension.



Secondly, people need to be free to work longer. This may involve delaying retirement or earning some income whilst partly drawing down on pensions. This requires flexible labour markets which do not marginalise those whose workplace needs are non-standard. Not only are youth unemployment rates shocking in much of the EU, employment rates amongst older people are shocking too and have declined dramatically as life expectancy has increased over the last generation, though in recent years we have seen some recovery.

EMPLOYMENT SCRAPHEAP

In many countries, including, France, Poland and Italy, 80 per cent of the workforce between ages 60 and 64 is economically inactive (the figure is 70 per in the EU as a whole). In some EU countries, people would expect to be retired for longer than they work. Working at older ages improves health outcomes, reduces the cost of providing pensions (both private and public) and increases the tax base. However, insider-outsider labour markets, especially in southern Europe, lack the flexibility that ensures that job offers can reflect the preferences of employers and employees effectively casting many people, both young and old, on the employment scrapheap.

REMOVING THE IMPEDIMENTS

Whilst I still view radical reform of pensions system as an imperative starting from where we are, a mix of policies to reduce the risk inherent in state pension systems, increase saving (not necessarily saving that is formally classified as 'pensions' saving) and removing the impediments to working will go some way towards reducing the impacts of the risks that are inherent in our fragile pay-as-you-go pensions systems. ●

PENSION COMMUNICATION

BY **FALCO VALKENBURG**

Generally speaking: people have no clue about their pensions. At the same time millions have been spent on pension communication over the last decades. Why is this? What can we learn? How can actuaries play a role? And shouldn't we go a step further than 'just' pensions?

Pension Communication should be high on the target list of the European Commission. The original Commission proposal for the revision of the European Pension Directive¹ envisaged 21 new Articles on communication. The result of the Trilogue² led to the inclusion of Articles 36-44, so 'only' 9 articles on this topic. It also provides more flexibility for individual Member States to transpose the requirements of the Directive in a way which is appropriate for the national specificities.

UNFAVOURABLE SCENARIO

Article 38 requires that IORPs provide members, at least annually, with a Pensions Benefit Statement. Such a Statement should include a disclaimer that pension 'projections may differ from the final value'. In case projections are based on economic scenarios Article 39 requires both a best estimate scenario and an unfavourable scenario.

ENCOURAGE INDIVIDUALS

The Actuarial Association of Europe proposed that 3 possible outcomes should be illustrated: 'best estimate', 'unfavourable' and 'favourable' as this would provide a better balance between risk and reward, and would also be more likely to encourage individuals to save for retirement which is a Commission objective.

APPROPRIATE MODELS

The projections will, of course, depend on the assumptions made about future investment returns, interest rates, inflation, wage inflation, mortality and other parameters. Member States will have considerable flexibility in how they determine these 'rules' as there is nothing in the Directive or its Recitals to constrain or guide them. Food for us, actuaries, to help and inform the decision making and develop appropriate models.

¹ DIRECTIVE (EU) 2016/2341 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the activities and supervision of institutions for occupational retirement provision (IORPs)

² Trilogue is the dialogue between European Commission, European Council and European Parliament

I would suggest to go for four scenarios. This would hopefully trigger thinking as there is no easy 'middle one' that probably otherwise would be used without giving it much further thought.

DISAPPOINTMENT

How will members appreciate this information? Probably the information is richer and more informative than ever. There is in my view a big 'but' to this though. What if a member has been a member in one or two other schemes in the past as well? What if a member has a spouse who is also a member in one or two schemes? Will they understand that they should add up the different pieces of information and they might not all be on the same basis? I have spoken to members that thought they were able to do this and that were so happy with their great monthly income after retirement. So happy, until I had to tell them that the amounts were not monthly amounts, but annual ... and not net of taxes yet but gross ... What a disappointment!

DREAMS

The Directive is really a step forward in providing good information about pensions. Members will need this as part of the information they are looking for. My experience is that a basic first question a member has is 'can I continue to live the life that I am living now?' Answering this question does need good pension data, but also information on possible other savings or investments or a house. In short it does require information of all income parts and information of all costs of living. With the current state of technology and access to individual data³ it is possible to present members or households a picture within 2 minutes that would show all their income components and all their expenses at and after retirement. From this information basis they could start

exploring alternatives that would suit them even better. And the choices are not that difficult: it is saving more or saving less, it is spending more or spending less and/or it is retiring earlier or later. These are the basic options for the majority of the population. Agreed, this goes (far) beyond the scope of the IORP directive, but it is a field where actuaries can really add value and where we can really help individuals and households getting grip on their lives. Let's take their dreams of how to live life as a starting point and then help them how they financially could make their dream come true! ●

³ The Payment Services Directive (PSD2) will shortly (to be implemented in national legislation before 18 January 2018) give individuals full access to their own data!!



Falco Valkenburg is Chairperson of the Pensions Committee of the Actuarial Association of Europe and member of the Occupational Pensions Stakeholder Group of the European Insurance and Occupational Pensions Authority.

FUTURE OF PENSIONS

Actuaries have a greater role to play in advising people how to save for retirement, particularly given Europe's ageing population and the rise of the gig economy. At a virtual roundtable on the future of pensions in Europe, several leading actuaries said this makes pension contributions and investment decisions critical.

BY **SARAH COLLINS**

GIG ECONOMY

"The gig economy means workers have no organised employment arrangements, they are not contributing to, or under the radar of, first pillar pension systems," explains Anne Drouin, chief actuary with the International Labour Organization (ILO).

Taxation systems and the nature of the work done by small start-ups and freelancers means they are more likely to spend than pay into second-pillar pension systems.

"When you've got Très Petites Entreprises (small 'mom and dad' firms), or 'auto employeurs' (the self-employed), quite often, they live on the company by paying for restaurants or buying a car, and also have a low salary, in order to pay less social contributions," says Richard Deville, a former benefits actuary. *"So, at retirement time, they have a very low pension."*

That leaves a ticking time bomb for future generations, says Charles Cowling, director at JLT Benefit Solutions. *"As actuaries, we ought to do more to highlight the risks of dumping, on the next generation, a basket-load of costs that we can't afford."*

FUNDING GAP

According to the European Commission, the ratio of workers to pensioners will halve by 2060 - from four to one now to two to one - leaving a large funding gap.

The first pillar, or state pension system, is buckling under the pressure, though Falco Valkenburg, chairperson of the pensions committee at the Actuarial Association of Europe (AAE), points out there has been *"a lot of improvement in financial sustainability"* over the last few years.

Methodology is an issue for Anne Drouin, with governments lacking *"identifiable benchmarks"* for calculating their pension needs (the ILO uses 40pc of a *"reference"* wage). The picture differs across Europe, with France having a significant but unfunded first pillar, while the UK has the opposite - less generous, but fully funded, with strict caps on pension increases.

WORKING LONGER

The upshot is that *"we need to work longer"*, says Falco Valkenburg, who estimates his children's retirement

age will be at least 72, four years higher than his own.

“The next generation all know they will have to work longer, they know they have to save for their own retirement and they don’t trust the system,” says Daphné de Leval, a senior manager at Deloitte Belgium.

“The work environment needs to improve, so people feel a bit more relaxed and happy to stay,” says Richard Deville. *“My parents had only 15 days’ vacation, but stress in companies was nothing to what it is now.”*

For Daphné de Leval, a *“flexible decent second pillar”*, or lifecycle employment-based pension system, needs to be put in place, particularly for freelancers and entrepreneurs.

RISK

But the participants were divided on how to value second pillar pension funds liabilities, particularly the methodology used to account for the risk of default.

“You can’t have generous pensions that are low-risk and cheap,” said Charles Cowling, pointing to the *“economic cost”* implicit in making a pension *“promise”*. He points to Tata Steel, which was almost bankrupted recently by a generous defined benefit scheme. For Falco Valkenburg, communicating to the market is key - *“clarity before solvency”*. While that can be achieved by using a risk-free rate for discounting and adjusting the conditional cash flows for risk, he points out that there might be an advantage in focusing more on cashflows, which don’t require a discount rate.

Daphné de Leval explains the *“more real world approach in Belgium”*, where the sustainable character of the technical provisions is assessed in line with the financing and investment strategy. Anne Drouin says actuaries should focus less on valuation methodology and more on finding a transparent way

to calculate pension contributions. *“The actuarial profession has not done its due diligence,”* she says. *“It has been influenced by the economic and accounting professions.”*

PERSONAL PENSIONS

The discussion took place just three months ahead of the European Commission’s forthcoming proposal on a pan-European personal pension product, something that also divided opinion.

“Work is not stable anymore,” says Daphné de Leval. *“You have to save for yourself in an international environment. This framework offers a unique opportunity to favour work mobility while supporting the EU real economy and financial stability.”*

But for most participants, different tax systems make pan-EU pensions attractive only for wealthy people who work internationally - though Falco Valkenburg points out they could spur competition in central and eastern European countries where there are *“very high cost-loadings”*.

CHALLENGES

“I think the challenge in all of our countries - and I think actuaries have got a lot to add here - is how we help people understand how much they need to live in retirement,” Mr Cowling said.

Another challenge relates to EU rules. *“EU regulations, such as Solvency 2, encourage insurance companies and their likes - ‘Institutions de Prévoyance’ and mutual companies - to invest in government bonds, rather than in equities and other investments, like infrastructure,”* says Richard Deville. *“Must the saving of the households, which is fairly high in France, be directed just to fund the debt of the state,”* he asks, *“or do we try to change the rules and channel it towards pensions, towards infrastructure and towards the real economy?”* ▶



CHARLES COWLING



FALCO VALKENBURG



DAPHNÉ DE LEVAL



ANNE DROUIN



RICHARD DEVILLE

The participants took part in the meeting in a personal capacity, and were not commenting on behalf of their employers.

PARTICIPANTS

Falco Valkenburg is a married father-of-two, who, after years spent advising large multinationals on how to optimise their employee benefits, realised happiness was the only benefit that mattered and left to start his own business. He is chairperson of the Actuarial Association of Europe's pensions committee and a member of the pensions stakeholder group at the European Insurance and Occupational Pensions Authority.

Anne Drouin is the ILO's chief actuary. Also an economist, Anne deals mainly with pensions and works on maternity and unemployment benefits. She is

currently helping to draft new international standards for social security programmes. She has two teenage children. Her contribution to this discussion was made on a personal basis.

Daphné de Leval, a senior manager at Deloitte Belgium, is a fellow at the Belgian and French actuarial associations. After starting off in pensions, she moved on to insurance, with a focus on Solvency 2. She is passionate about risk management, and finding a balance between social and economic issues. She has a young daughter and likes running in her free time.

Charles Cowling is a director at JLT Benefit Solutions, a UK-based advisory firm, and chair of the international board at the International Actuarial Association.

He has worked not only as an pensions actuary, but also on investment and executive pay. He is an avid athlete, once running 10 marathons in 10 days.

Richard Deville is the executive officer at the 'Centre des Professions Financières', a French think-tank. Prior to joining the Centre, Richard worked as a benefit and investment consultant at Mercer, Watson Wyatt and OptimindWinter, in aviation/ space insurance and at the largest federation of mutual insurance companies in France. He is a fellow and head of the international department at the Institut des Actuaire. ●

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5 congress days with a first-class congress program and eminent guest speakers, up to 11 parallel lecture halls, over 200 lectures by more than 250 speakers, 6 exclusive limited attendance experiences and an entertaining social program – the ICA 2018 is getting closer.

From 4-8 June 2018, the German Actuarial Association, in conjunction with the International Actuarial Association, will host the 31st International Congress of Actuaries in Berlin. With around 2,000 participating experts from all over the world, the ICA is considered to be the leading international conference for actuarial science and mathematical finance.

As part of the **1st announcement**, the ICA 2018 has just published the Call for Papers for the congress program. In total, the congress program includes 11 parallel sessions with about 100 slots for the presentation of submitted papers. Each parallel session will last 90 or 120 minutes and consist of a number of 30- to 45-minute talks. Actuaries, scientists and practitioners are encouraged to participate in shaping the program by submitting relevant, leading-edge ideas, research results and insights that will expand and grow the current body of actuarial knowledge.

Further information and the full 1st announcement can be found on www.ica2018.org.

INTERVIEW WITH BRIAN HAYES

BY **PETER TOMPKINS**

One of the goals of the IORP Directive is enabling and facilitating Cross border pension activities and pension transfers. What improvements in this respect do you see in the IORP II Directive as compared to IORP I?

‘One of my key goals as rapporteur of the IORP II Directive was to try to build a stronger internal market for occupational pensions, by making cross-border transfer rules simpler and clearer. We know from the IORP I Directive that take-up of cross-border IORPs has not been successful. And I am aware that Member States have certain sensitivities about the transfer of pension schemes abroad but it really is an area where we require improvement if we are to have a properly functioning EU marketplaces for occupational pensions. And I do believe that the new rules in the IORP II make it easier for businesses to set up workplace pension schemes in the different Member States where they operate. No longer will regulators simply be able to block businesses from moving their

pension scheme to a new location - now both regulators have a role in a cross-border transfer and can only block transfers on a strict set of criteria. This is a novel approach that has never been introduced in any other EU legislation. This will prevent regulators from blocking a transfer on arbitrary grounds. If two regulators disagree on whether a cross-border transfer should go ahead, the European Pensions regulator EIOPA, can mediate in order to settle a disagreement.

We have also ensured that cross-border pension funds in the EU do not suffer the same stringent funding rules. Previously, cross-border funds needed to be fully funded at all times but now we have now provided in legislation that such funds can go into periods of underfunding whenever there are difficulties in financial markets. This was an important negotiation point for the Parliament and the outcome is important as it reflects the reality that all pension funds are susceptible to periods of underfunding.’ ▶



BRIAN HAYES
is Member of the
European
People's Party.

You played a very important role as the Econ rapporteur in Parliament. It is also a very difficult role given the many diverse views. What was your biggest challenge and your greatest achievement in the process to a compromise text in Parliament?

‘The biggest challenge as rapporteur was to convince the Council of the merits of developing a proper cross-border market for pensions. For many Member States, the priority was about ensuring that their own pension system was not negatively affected by EU rules and I do agree that this is important. But it took a long time to get Council to have a proper negotiation on cross-border rules. At the same time, it was important to keep the political groups in Parliament united so that we could achieve some of our key goals. In the end, I think we achieved the right balance between respecting the differences between Member States’ pension systems while also encouraging pension mobility.

I think it was an important achievement that five political groups were able to support the final outcome, from the left and the right side of the house. Keeping political groups together was often very difficult and both sides had to make concessions. But the fact

that we kept united throughout the process was important for Parliament in securing a good deal, particularly around aspects related to cross-border rules, ESG factors, depositaries and the pension benefit statement. Ultimately 512 MEPs voted in favour of the final text and I think this shows that the majority of the rules in the agreement were appropriate and struck a good balance.’

The Directive states that investments should be “... in the best long-term interests of members and beneficiaries as a whole’ and that ‘Within the ‘prudent person’ rule, Member States shall allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social, and governance factors”. What is your interpretation of the best long-term interests of members and beneficiaries as a whole?

‘Pension funds are long-term investors and therefore they must be able to take a longer view in terms of investment decisions and whether such decisions could be negatively affected by certain factors. This should be about ensuring that pension fund managers do not always manage their portfolio on the basis of the short or medium-term

performance of the fund. Pension fund managers have a duty to act in the long-term interests of members and beneficiaries and it is important to address this in legislation. And as part of this, environmental, social and governance factors can affect the investment portfolio of a pension fund - they are issues that typically emerge over long periods of time and may not be easy to predict. These issues are reflected in the UN’s Principles for Responsible Investment and as legislators we felt it important to establish them in legislation.’

What is your view on the balance between protecting stable retirement benefits to the older generation in the short run and securing attractive investments in a long-term perspective for the younger generations? To what extent can different generations expect to show solidarity towards each other?

‘I believe there should be some form of intergenerational solidarity where appropriate and where possible. But whether that needs to be addressed through EU legislation, I am not so sure. This was a difficult negotiation point but what we arrived at in the legislation is that IORPs as a general principle should take into account the aim of having



an equitable spread of risks and benefits between generations. This may be difficult for regulators to implement but I do think there is sufficient flexibility so that IORPs do not have to change the way they operate but that in general they should take into account the goal of ensuring that both older and younger generations secure their retirement income. How this is done must be for Member States to decide. Risk sharing in pension schemes is always extremely difficult and there is a very fine balance. And the level of risk sharing needed may vary significantly from one scheme to another. But what we should be looking at is that younger generations are not paying over the odds to fund beneficiaries and equally beneficiaries should not take the bigger hit when it comes to benefits being cut. There does not to be some equality in the risk sharing but I don't think this is something that we can concretely address in the IORP Directive.'

How do you see the co-legislators resolving the current differences in relation to performance scenarios specified the PRIIPs RTS? Should the projections to be provided to members of DC IORPs adopt a similar approach to the PRIIPs KID? Why does IORP II not require members and prospective members of DC IORPs to be provided with a projection on a "favourable" basis as well as an "unfavourable" one as this might help to encourage individuals to save for retirement?

'It still remains to be seen how the PRIIPs RTS will be resolved. I believe the ECON Committee was quite clear in upholding the original Regulation requirement of providing information which is 'accurate, fair, clear and not misleading'. But it is now up to EIOPA and the European Commission to ensure that the new RTS is in line with the Parliament's views.'

I do think that for DC IORPs, future projections should not be such an integral part of the information provided to members and beneficiaries since there is a set contribution and there is no pension promise. IORP II does require members and beneficiaries to be provided with a best estimate scenario, which in my view could be a favourable scenario done on the basis of best estimates. The most important thing is that members and beneficiaries should be provided with the most accurate as possible information. This should include an unfavourable scenario which is always possible and a best estimate scenario which can be something positive and encouraging for those who want to save for their retirement. But Member States should have sufficient flexibility to more clearly define how unfavourable and best estimate scenario should be transposed into law.' ●

ARE YOU NOT YET BLOCKCHAINIZED?

BY MARK HEIJSTER

Experts have their hands full. Insurance companies, start-ups, banks and other financial institutions, all seek advice to entice new customers with products that are based on the blockchain protocol.



MARIE-LINE RICARD

According to **Marie-Line Ricard**, Blockchain Lead Partner at PwC France, 'If we are to believe the people involved, we face a new era.' The protocol in which two parties, without the intervention of a third party, enter into a reliable contract, could completely mess up the insurance industry over the coming months. Insurers and financial institutions see it as a race against the clock.

Developers of all kinds of new financial and insurance products enthusiastically study the potential of the protocol. It can form the basis of renewed confidence in the financial world and perhaps as Ricard puts it: 'create a better world by building new synergies based on new circles of interest and trust.'

ADDED VALUE

In the past few months, one after the other, start-ups in the insurance business have embraced the new protocol in order to see if the technology could also be useful for them. These are exciting times for Blockchain consultants Sébastien Choukroun and Jean-Baptiste Monnier,

busy accompanying customers in finding possible applications for the blockchain.

Monnier: 'People are trying to understand what exactly the added value of this new technology is as well as the impact of decentralization and potential additional autonomy given to each participant. How can we leverage on this technology to better improve our businesses and the relationships we have with our clients and partners in the insurance industry? In addition, there are rules built into the protocols that allow the various parties to trust each other and to do business together.'

The new protocol creates confidence by allowing for more transparency.

Monnier: 'What happens to your premium? Is it totally consumed to pay back the damages or is it profit at the end of the year? Most existing so called peer-to-peer insurance companies now offer full transparency, they will tell you that 20 percent is profit and operational costs and that the rest is used to pay back claims. This is a big

difference from traditional insurance businesses.'

Choukroun: 'For many years insurers have built very complex systems. At some point nobody understood the whole picture anymore. There are now people who say that they would prefer to start from scratch. There is in fact a chance to redesign the system.'

SMART CONTRACTS

Concerns also exist. One of the characteristics of the protocol is, after all, that third parties are no longer needed. Insurance companies are forced to take a closer look at their own businesses so as to redefine their own added value for the customer.

Monnier: 'In a very basic setting you can imagine that smart contracts might help provide a service at a very marginal cost. This requires simplification so things need to be very standardized. What we now see in practice is that you need a third person to handle all the specific cases.'

Standardization will smooth the traffic between insured and insurer. In so-called smart contracts the terms and conditions will be laid down in a blockchain, and if these are met the payment of compensation follows automatically. The disbursement can occur in a matter of seconds. Since this is a completely automated system, you no longer have a lot of paperwork. You

only need a few people to maintain the computer network. Therefore this development will certainly cost jobs.

PERSONALIZED CONTRACTS

Choukroun: 'The availability of big data will also play a more important role. As we get more and more data on an insured person we can personalize the insurance and adjust prices.'

In addition, a smart contract offers new opportunities according to Choukroun: 'For many objects there is no suitable insurance. Drafting a separate contract costs too much. In such a case a smart contract combined with low premium would be a solution and could possibly attract new customers.'

For the time being, the multiple applications of the blockchain create a positive mood among experts and developers. This could of course change rather quickly since nobody knows how the market, insurers and customers will really react. A rapid introduction of blockchainized products could chase the customer away. On the other hand no insurer wants to miss the boat. Some experts expect a large acceleration, whilst others suppose the market will adapt little by little. Time will tell. ●

SÉBASTIEN CHOUKROUN



JEAN-BAPTISTE MONNIER

EUROPEAN PENSIONS

CONCEPTUALLY FLAWED, NOT FIT FOR PURPOSE AND MISLEADING TO THE PUBLIC?

BY **ALF GOHDES**



The German Pension actuaries' view of EIOPA's Opinion to EU Institutions on interpreting IORP II

ALF GOHDES is a self-employed actuary in Germany

In its Opinion of April, 2016 EIOPA (the European Insurance and Occupational Pensions Authority) published its views on how pension funds' supervision is to be structured after the enactment of IORP II, the second European Pension Fund Directive. In keeping with the European Commission's and its own long-held strategy, EIOPA recommends adopting the Common Framework ('CF'), for purposes of risk assessment and transparency.

This article summarises the German Institute of Pension Actuaries (IVS) response submitted

to EIOPA in October of last year. [> go to article ¹](#)

While the IVS agreed with and welcomes many proposals in the Opinion, it disagrees with some fundamental aspects. In summary, the IVS concluded that the proposals are conceptually flawed, not fit for purpose and misleading to the public. Also, the IVS puts forward an alternative approach it considers to be more in line with the spirit of IORP II.

MOST PRACTICAL FOR EIOPA
Although the IVS supports the goals that a consistent assessment of

risks and solvency of IORPs should be reached, it believes that EIOPA's proposals counteract these very goals. For example,

- EIOPA's intention to increase the security of defined benefit promises by radically increasing funding, benefits primarily those already in possession of such benefits. The fact that such funds will have to be withdrawn from other usage means that future generations will pay for this by lower benefit, which in turn results in a problematical intergenerational issue.
- EIOPA has stuck to its original logic that because insurers and IORPs run essentially very similar businesses, they can be regulated on the same conceptual basis. The fact that the two types of institutions are fundamentally different in character is fundamentally ignored.

In proposing how to implement the common risk-assessment for IORPs, EIOPA argues that a market-consistent balance sheet and standardised risk assessment should be performed in accordance with the CF. Although this is valid in principle, EIOPA then goes on to state that the most important measurement elements to be

used – namely a risk-free discount rate and risk factors calibrated to a 0.5% probability of occurrence over a one-year horizon – are identical to those devised for insurers and adopted for apparently no other reason that this is “most practical for EIOPA”. This justification is at best unreasonable.

CONTRADICTION

The Opinion also strays into policy by proposing that the National Supervisory Authorities should be given “sufficient powers to take supervisory action based on the outcomes of the CF ... to achieve supervisory objectives as defined by EU and national law”. This is in contradiction with IORP II, which specifically rules out the CF as a measure for funding and capital adequacy.

INTENTION OF POLICY

Considering that the IORP sector in Europe holds about half as much assets as the life insurance sector (€2.8tn vs. €5.5tn) and that the three main IORP-jurisdictions by assets, namely the UK, NL and Germany, have very different legal and regulatory environments for IORPs that have developed very differently for more than a century, the IVS goes on to propose an approach that is evolutionary

rather than revolutionary. This can only be done by implementing a CF fundamentally different from that proposed by EIOPA.

The central aim of such a new CF must be to find a regulatory basis that is appropriate for IORPs and not one that is the most practical for EIOPA! The IVS contends that the conceptual ideas underlying the CF can then be consistently applied in each Member State in accordance with existing national risk management and funding standards applicable locally. This was the intention of the policy makers responsible for enacting IORP II.

Although somewhat pessimistic, I still hope that EIOPA fundamentally reconsiders its opinion. ●

¹ Link to DAV Website:
https://aktuar.de/unsere-themen/fachgrundsaeetze-oeffentlich/2016-10-05-IVS-Ergebnisbericht-EIOPA-Common-Framework_v1.pdf

THE ACTUARIAL FUNCTION AND ITS FIRST APPLICATION IN ITALY

BY **GIAMPAOLO CRENCA**



The Actuarial Function was introduced in Italy on 1st January 2016 according to the new Code of Insurance that, at the same time, issued new rules about the Solvency II regime.

In spite of this, the Government didn't listen, and so in the new Code of Insurance only the Actuarial Function was introduced. Fortunately a specific rule provides that the qualified Italian Actuary (enrolled in the official list 'Albo') is already *fit and proper* and so he/she has automatically recognised their professional skills. Unfortunately another rule said that also other kind of persons can be entrusted as Actuarial Function but he/she must show to get the professional skills; hence, in this last case, the *fit and proper* approach cannot be applied.

DIFFERENT FIELDS

In spite of this, thanks to a very strong *marketing* action by the National Actuarial Council, actuaries in Italy were able to maintain all the professional tasks and to enlarge the market of the actuaries employed in the Insurance Companies, Life and non-Life. So the actuarial work increased due to the activities of the previous Appointed Actuary and Auditor Actuary that remained the same and to the new work coming from the Actuarial Function, Risk Manager Function and Solvency II; so many actuaries work in different fields inside an Italian Insurance Company including accounting, distribution, IT, internal auditing, etc.... as the solvency II approach enlarged the view and hence the opportunities of work for actuaries.

GREAT CHALLENGE

At the same time the Auditor Firms continue to entrust actuaries to verify the technical reserves calculated according to Local Gaap standards and also part of the solvency II process, so from a general point of view Italian actuaries continue to increase in number in the official list but above all in terms of quality of work and position/governance inside the insurance companies: it is a great challenge for actuaries.

GOVERNMENT PROCESS

At the moment we must also observe that over 90% of tasks in the Actuarial Function were assigned to actuaries enrolled in the list (application of *fit and proper* rule) with sufficient experience, employed and external professionals, and the residue are in

any case persons which get good professional skills, so from this point of view the Actuarial Function has been well considered in the market and actuaries have and will have a good space, also because in many insurance companies they are entering in the governance process, for instance they are attending the Board presenting own report and other aspects.

STRATEGIC RULE

Some actuaries, moreover, were entrusted as Risk Manager. Another important rule, introduced by the new Insurance Code, provides that a technical note for the tariffs of all lines of business in general insurance must be written (in the past the technical note was only compulsory for Life and motor insurance). It is a very strategic rule and it means much work and space for actuaries, employed and external professionals.

2017 IMPORTANT YEAR

Obviously there are many other questions to be solved and faced; we are at the beginning but some important basic points have been developing in a good direction. Our effort is to support all these activities through a good training (permanent training is compulsory for Italian Qualified Actuaries enrolled in the list), to provide guidelines (work in progress) looking at AAE's indications, to continue *marketing* above all about quality and governance; so, 2017 will be a very important year. ●

COLUMN OF THE AAE

This year the first Solvency II reports will be published.

Will Solvency II lead to more transparency? And more specifically transparency to the benefit of policyholders? Soon we will know, as the first annual reports under the Solvency II regime will be presented. What to expect? First of all: real Solvency II numbers. This time no approximations or computational exercises on behalf of a European stress test, but real numbers audited by an auditor, who will rely on the review work done by a fully qualified actuary. Over the last fifteen years, Solvency II was gradually embraced by the insurance industry. But there was no choice of course. The original opinions about “an unnecessary and costly activity” slowly moved to “the only way to control an insurance company.” And so it is.

One of the main objectives of Solvency II is to increase transparency (the famous ‘pillar’ 3) and more “disclosure” (“public disclosure”). That has to be addressed. The report on the solvency and financial position in the annual report will have to give this insight including “a description - separately for each risk - the risk exposure, concentration, mitigation and sensitivity”. I am, in the most literal sense, curious to find out. For insurers, this is a great opportunity to proactively disclose useful information in understandable language. Obviously, this report will be published in the local language. Despite all the good intentions it will be a challenge for the average policyholder to take this amount of information and to digest. So here again are good opportunities for insurers to enter into dialogue with their customers. How much goodwill could be achieved by publishing a separate financial report, bespoke to policyholders? In addition, it could be an interesting job for an independent body to make a clear comparison with a comprehensible explanation of the differences between the various insurers, and what these differences could mean for the policyholders’ reasonable expectations.

As an actuary, I am particularly interested in the auditor’s and actuary’s detailed review report on the group’s or company’s solvency. And I am specifically interested in the paragraph about model risk, as most of the models used will not be able to handle negative interest rates appropriately.

So, all in all we will have an interesting year before us: for the actuarial specialist, but hopefully also for the interested policyholder.

Ad A.M. Kok AAG Hon FIA
Chief Executive
Actuarial Association of Europe

COLOPHON

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