



IORP II

Actuarial and Risk Management Function

A very important support to pension funds

Falco Valkenburg

Rome, 22 November 2018

Established in 1978 by 12 national associations

- Belgium, Denmark, France (2), Germany, Ireland, Italy (2), Luxembourg, Netherlands, UK (2)

Now representing over 24,000 actuaries in Europe

- Full Member Associations (33)
- Observer Member Associations (3)
- In 35 European countries

Purpose

- advise European institutions on issues of actuarial interest
- provide a forum for discussion among actuarial associations in Europe
- promote high standards of education and professionalism
- further the education and professional development

“... contributing to the well-being of society ...”

IORP II fits into a broader range of pension topics of the European Commission

Ageing of the European Union

- Latest report published on 24 May 2018 (triannual report)
 - Challenges regarding the (financial) sustainability
 - By DG ECFIN
- Adequacy report published on 30 April 2018 (triannual report)
 - Challenges regarding 'Adequacy and Fairness'
 - By DG EMPL

IORP II Directive

- X-border pensions
- European Capital Market
- Consumer Protection

Pan-European Personal Pension product

- Offers an alternative in case 1^{rst} and 2nd Pillar not sufficient

REVISED IORP DIRECTIVE

IORP = **I**nstitution for **O**ccupational **R**etirement **P**rovision

IORP \approx Pension Fund \approx Fondi Pensione

IORP I

Directive 2003/41/EC

*on the activities and supervision of
institutions for occupational retirement
provision*

33 pages

40 recitals

24 articles

ratio articles/recitals 0.60

no titles

word count 'actuary': 4

word count 'actuarial': 6

741.70 kB

IORP II

Directive (EU) 2016/2341

*on the activities and supervision of
institutions for occupational retirement
provision (IORPs)*

49 pages (+48%)

81 recitals (+103%)

67 articles (+179%)

ratio articles/recitals 0.83 (+38%)

VI titles (+∞%)

word count 'actuary': 2 (-/-50%)

word count 'actuarial': 15 (+150%)

678.41 kB (-0.9%)

2008: Basic question:

- *How to implement Solvency II for IORPs?*
 - not *'whether'*

2011: Call for Advice to EIOPA

2013: Barnier: 'no Pillar I changes'

2014: Commission proposal for revision

2016: Trilogue compromise

2017: Into force on 12 January

2019: Implementation into national law by 13 January

Solvency II Framework (analogous to Basel II for Banks)



~~Pillar 1~~

~~Rules for
valuation of:~~

- ~~-Assets~~
- ~~-Liabilities~~
- ~~-Capital
requirements~~



Pillar 2

Supervisory review
process including:

- Effectiveness of risk
management
- Corporate
governance
arrangements



Pillar 3

Disclosures:

- Public
- Private (to the
regulator)

As promised: no significant Pillar I changes

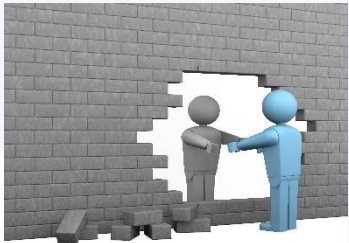
*‘... is aimed at **minimum harmonization**...’ (Recital 3)*

*‘... **does not concern** issues of national social, labour, tax or contract law, or the adequacy of pension provisions in Member States’ (Recital 3)*

*‘... aims to ensure good **governance**, the provision of **information** to scheme members and the **transparency** and safety of occupational retirement provision.’ (Recital 4)*

IORP II

4 Main objectives:



Removing remaining prudential barriers for cross-border IORPs



Ensuring good governance and risk management



Providing clear and relevant information to members and beneficiaries



Ensuring that supervisors have the necessary tools to effectively supervise IORPs

Cross-border Procedures (Article 11)

Colosseum IORP

Example:
Italian IORP
to carry out
Dutch pension plan



Italian IORP

Request and
information

On-going
supervision



*Home State
Authority*

Communicate within 3
months

Information on social and labor
law requirements within 6 weeks

On-going supervision
as to social and labour
law requirements



*Host Member State
Authority*

Cross-border Transfers (Article 12)

Costs of transfer not incurred by members/beneficiaries

Subject to prior approval by:

- The members and beneficiaries
- The sponsoring undertaking

Authorisation Home Member State Authority receiving IORP
after obtaining prior consent Home Member State Authority of
transferring IORP

Assessment by Authority of transferring IORP

- Long-term interests members/beneficiaries remaining part adequately protected
- Individual entitlements not reduced
- Assets sufficient and appropriate

Home Member State Authority to communicate results of
assessment within 8 weeks

non-binding mediation by EIOPA possible

New is:

*‘... in the best **long-term** interests of members and beneficiaries as a **whole**’ (Article 19.1.a)*

‘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’ (Article 19.1.b)

Fit and proper requirements

- qualifications, knowledge and experience are collectively adequate
- good repute and integrity

Key Functions

- Risk Management Function
- Internal Audit Function
- Actuarial Function, where applicable

Requirements for all Key Functions (Art 24)

Objective, fair and independent

“shall report any material findings and recommendations”

- to the administrative, management or supervisory body
- to the competent authority in case: a) that the IORP will not comply with a materially significant statutory requirement or b) a significant material breach of the laws, regulations or administrative provisions is observed (whistleblowing)

Actuarial Function (Art 26)

- a. coordinate and oversee the calculation of technical provisions;
- b. assess the appropriateness of the methodologies and underlying models
- c. assess the sufficiency and quality of the data
- d. compare the assumptions with the experience;
- e. inform the IORP of the reliability and adequacy of the calculation of technical provisions;
- f. express an opinion on the overall underwriting policy
- g. express an opinion on the adequacy of insurance arrangements
- h. contribute to the effective implementation of the risk management system.

Position of the actuary

*‘A prudent calculation of technical provisions is an essential condition to ensure that obligations to pay retirement benefits can be met **both in the short and the long term.** Technical provisions should be calculated on the basis of recognised actuarial methods and certified by **an actuary or by another specialist in that field.** The maximum interest rates should be chosen prudently according to any relevant national rules. The minimum amount of technical provisions should both be sufficient for benefits already in payment to beneficiaries to continue to be paid and reflect the commitments that arise out of members' accrued pension rights. **The actuarial function should be carried out by persons who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the activities of the IORP, and who are able to demonstrate their relevant experience with applicable professional and other standards.**’ (Recital 40)*

- How own risk assessment is integrated in decision-making
- Effectiveness of risk management system
- Potential conflicts of interest with sponsoring undertaking
- Funding needs (incl recovery plan if applicable)
- Assessment of risks to members and beneficiaries
- Qualitative assessment operational risks
- Environmental, social and governance factors

Implementing Key Functions: some observations

My Observations in my own country

Preference Dutch supervisor:

- Key Function Holders are Board Members/Trustees
- except Actuarial Function → Appointed/Certifying Actuary

Dutch IORP federation:

- Key Function Holders can be external

Dutch Chartered Accountants:

- More own assessment of accountant needed if certifying actuary also performs Actuarial Function

Implementing Key Functions: my own thoughts

Lines of Defence

First line	Board/Trustees
Second line	Risk management, Compliance, Actuarial function
Third line	Internal Audit
Fourth line	Supervisory Board
Fifth line	External Auditor, Certifying Actuary
Sixth line	Competent Supervisory Authorities

My thoughts:

- Key Function Holders in the Board would create a division in the IORP Board
- Actuarial Function is a function separate from certifying the provision
- Combining Actuarial Function and Risk Management Function is allowed
 - Great opportunity for actuaries!!

Pension Benefit Statement

- *using clear, succinct and comprehensible language,*
- *avoiding the use of jargon,*
- *not misleading and*
- *easy to read*

- Information on **benefits projections**
 - include **best estimate scenario and unfavourable scenario**
- Breakdown of costs
- Member's options
- For amounts expressed in annuities:
 - assumptions, type of provider, duration of the annuity

Article 7 on the “Activities of an IORP” has an interesting last sentence:

*“As a general principle, IORPs shall, where relevant, have regard to the aim of having an **equitable spread of risks and benefits between generations** in their activities”*

STRESS TEST FOR PENSIONS



ACTUARIAL ASSOCIATION OF EUROPE

2017 IORP Stress Test

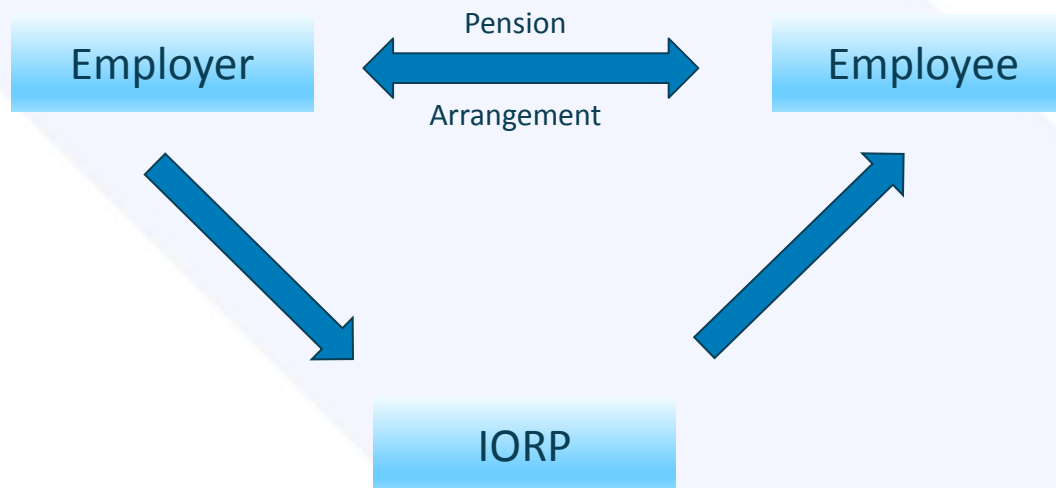
Some observations, questions and suggestions from an actuarial perspective

Falco Valkenburg

Frankfurt, 21 March 2018

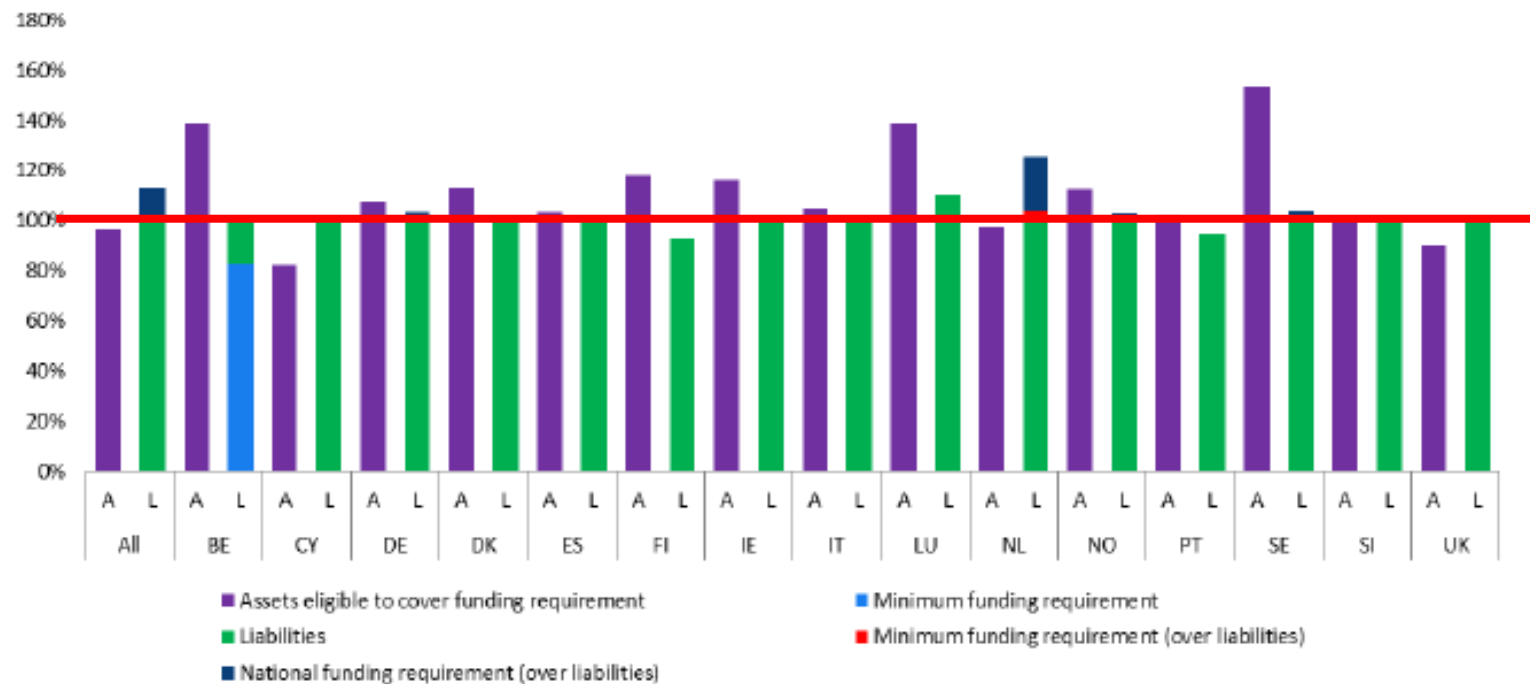
Introductory remarks

- Most IORPs are social institutions, not financial
- We believe that IORPs are to some extent stress absorbers
- We suggest that the ESRB should therefore look at IORPs with a different approach than banks and insurers
- The basis for IORPs lies in the triangular relationship as stated in the IORP Directive:



National Balance Sheet - baseline

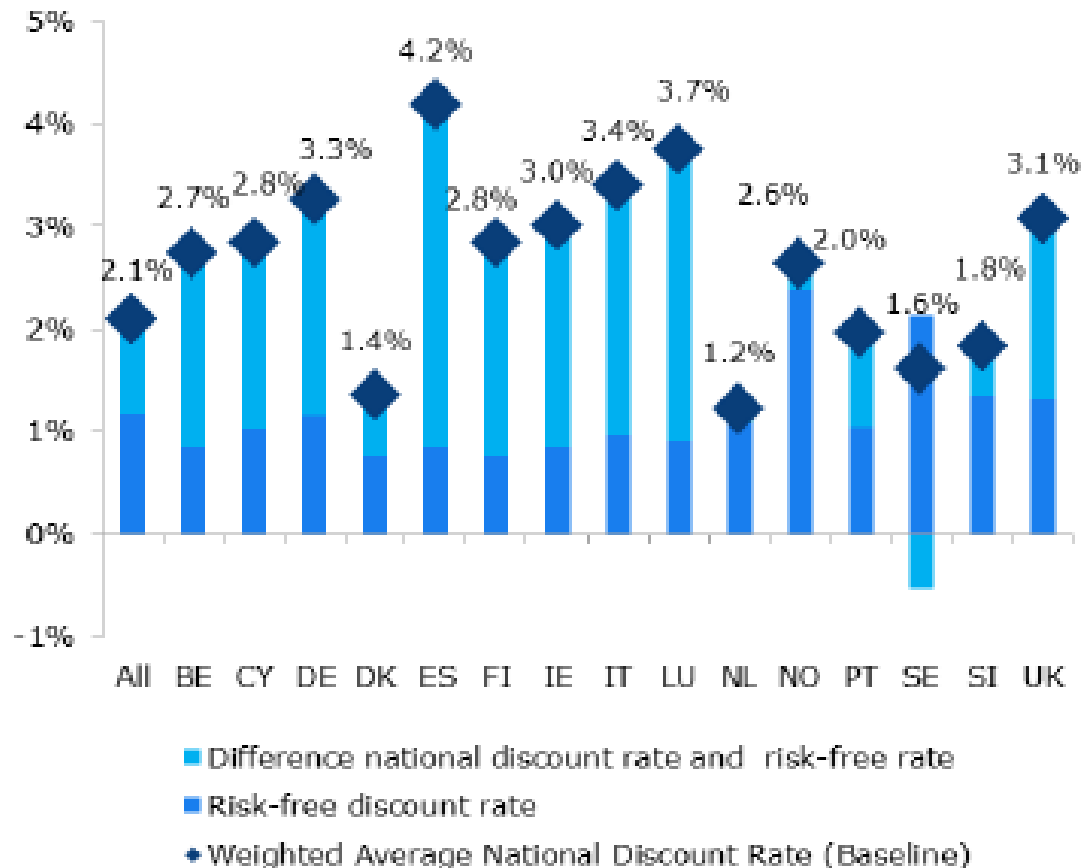
Figure 3.6: Assets, liabilities, national funding requirement (over liabilities) and, where available, the minimum funding requirement in baseline scenario by country, % liabilities



Results look pretty much OK on these national bases.

National Discount Rate - baseline

Figure 3.5: National discount rate in baseline scenario by country, liability weighted average, %



- Significant spread in discount rates

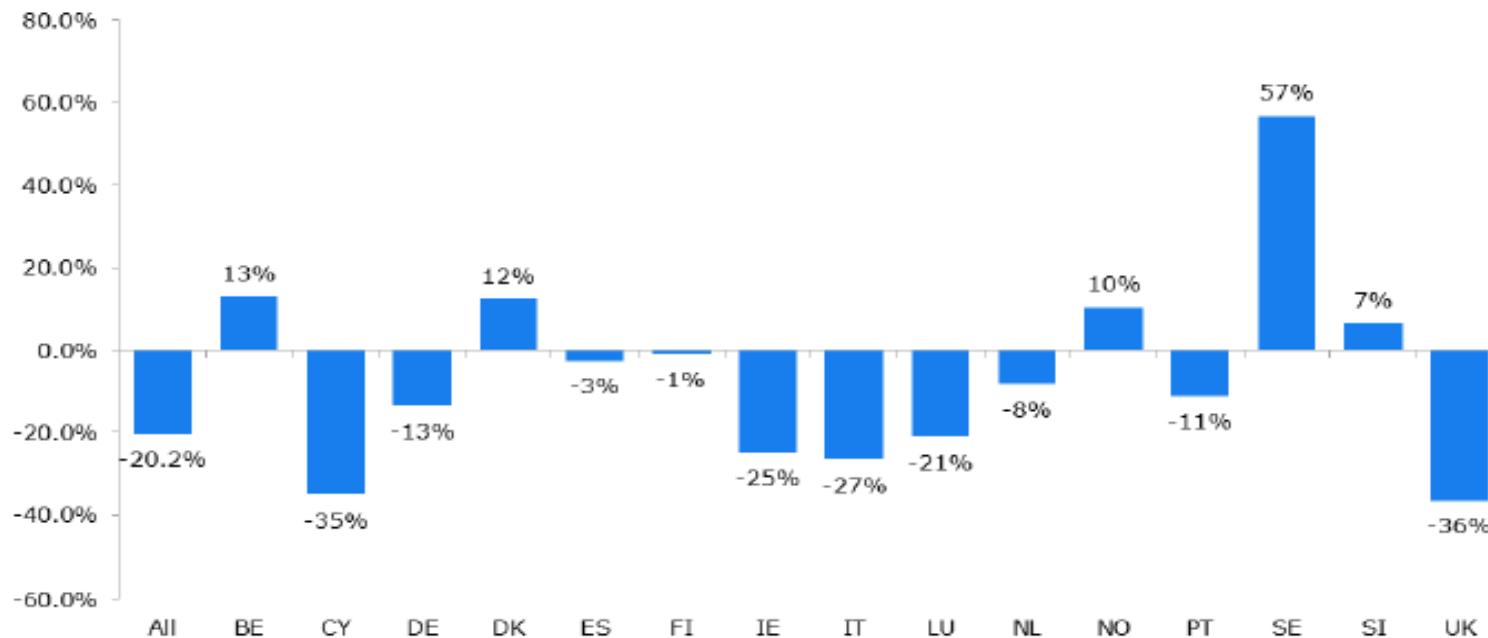
- Theory:

$$\text{Discount Rate} = \text{Risk Free Rate} + \text{Risk Premium}$$

- Risk Premium depends on the nature of the pension promise
 - If pensions are guaranteed: risk premium = 0
 - If softer: risk premium > 0
- As most pensions are guaranteed:
 - Generally too high discount rate used
 - Liabilities understated
 - Funded status too optimistic

Common Framework - baseline

Figure 3.15: Excess of assets over liabilities (excl. sponsor support, pension protection schemes and benefit reductions) in baseline scenario, % liabilities (excl. benefit reductions)

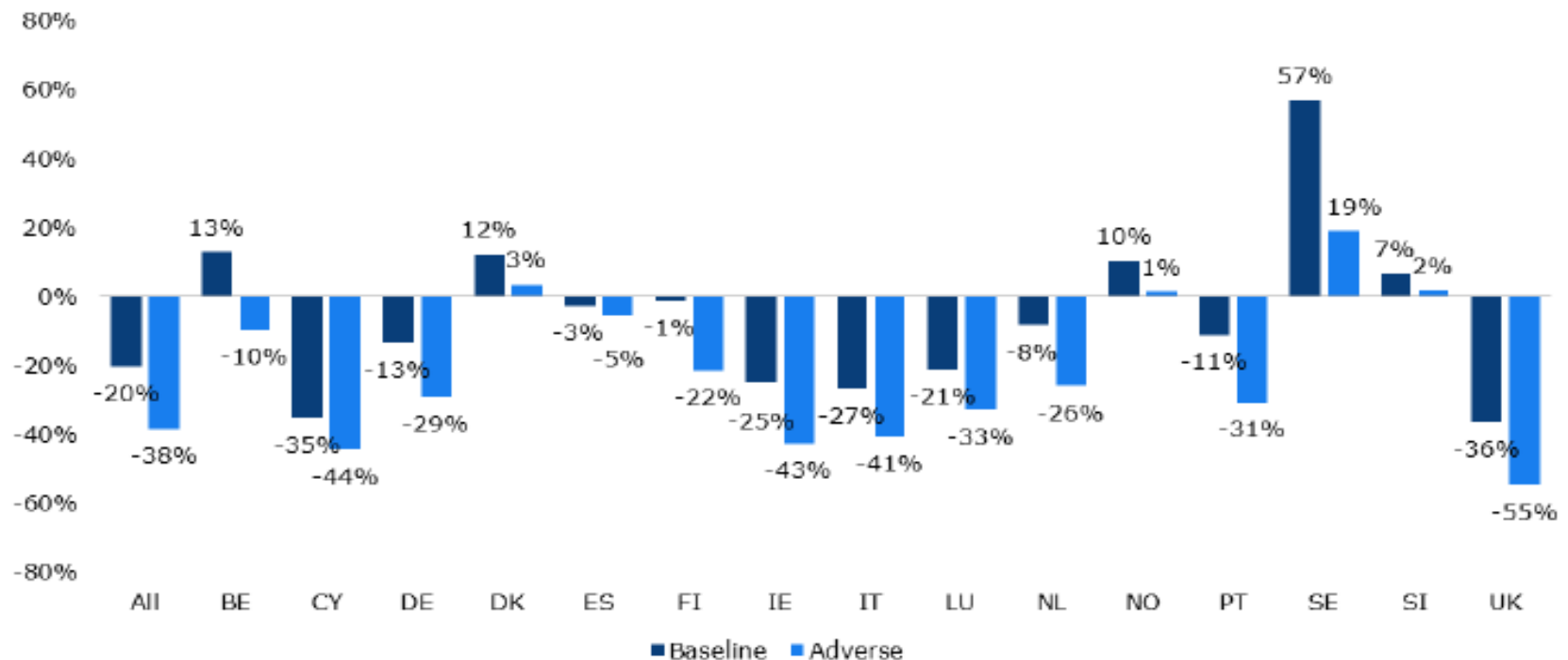


Discount rate = risk free rate

Overstatement of liabilities in some jurisdictions, but generally a better reflection of the pension promise. **Serious under funding (in the baseline!) in most jurisdictions.**

Common Framework – baseline + adverse

Figure 3.30: Excess of assets over liabilities (excl. sponsor support, pension protection schemes and benefit reductions) in baseline and adverse market scenario, % liabilities (excl. benefit reductions)



Deficit baseline 20% or EUR 349bn
 adverse 38% or EUR 702bn
Keep in mind: these are condensed long term figures!

Immediate discussion needed by stakeholders.
 Could result in: communication (managing expectations) and/or financial measures.

Sponsor support and benefit reductions

Figure 3.39: Value of sponsor support in baseline and adverse market scenario, % liabilities excl. benefit reductions

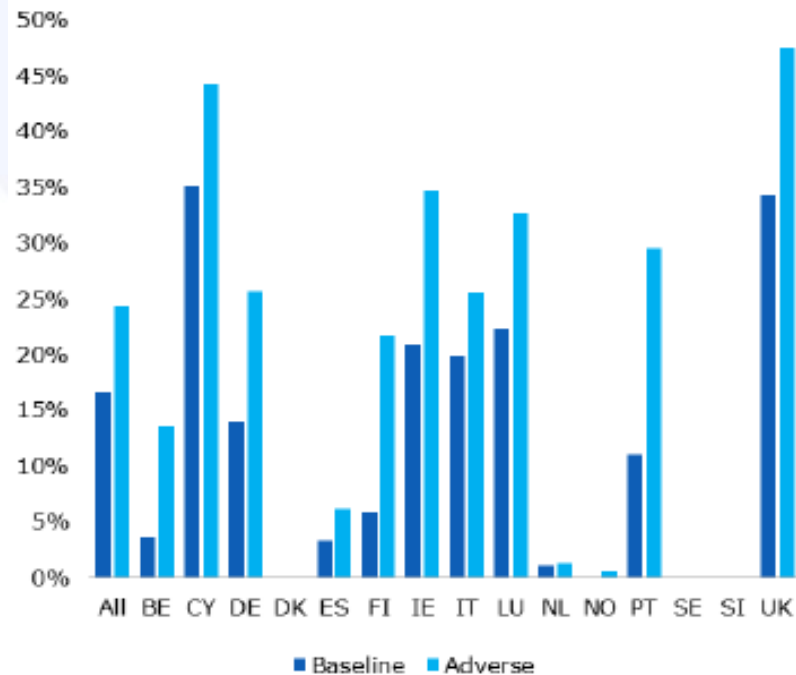
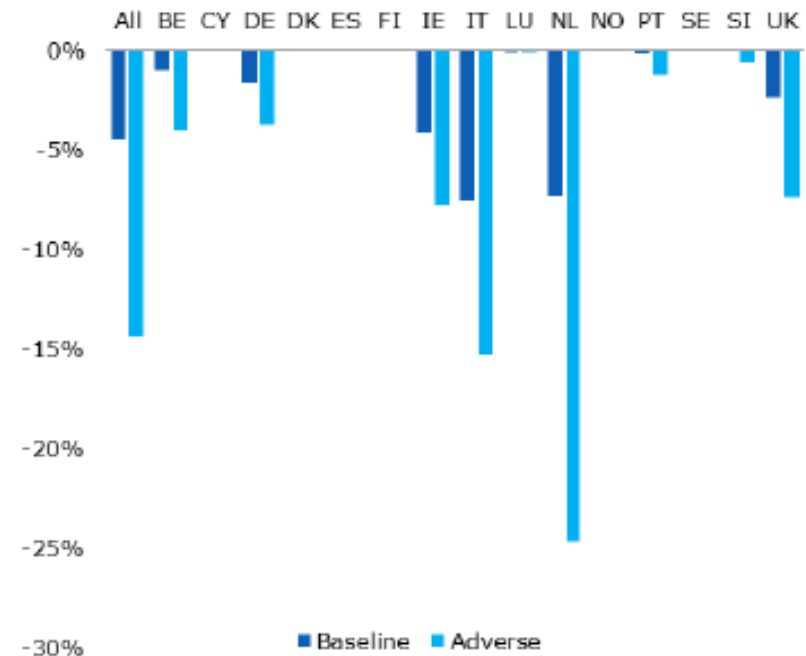


Figure 3.40: Value of benefit reductions in baseline and adverse market scenario, % liabilities excl. benefit reductions

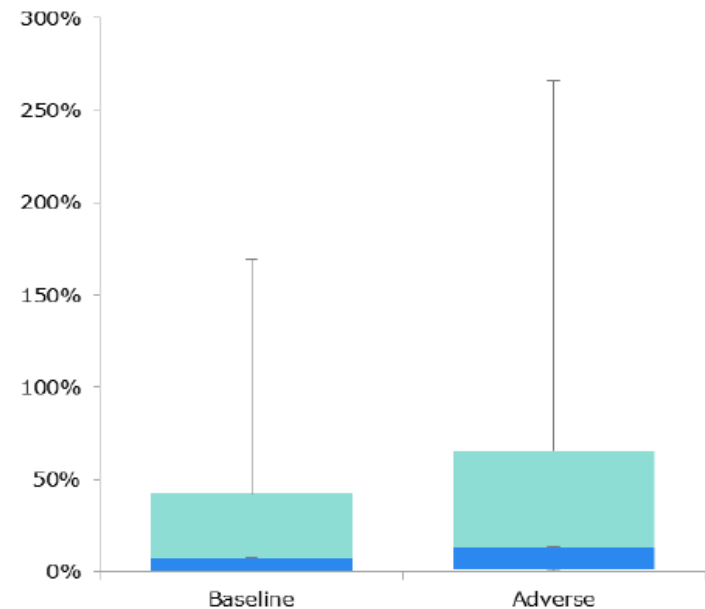


Serious impact, even in the baseline, for a good number of IORPs. Shows the importance that stakeholders discuss the results as the impact could be serious. Communication and/or financial measures might be needed.

Sponsor support and benefit reductions

- For **25%** of participating IORPs, the value of **sponsor support** on the common balance sheet **exceed 42% of the sponsors' market value in the baseline** and **66%** in the adverse scenario
- For **10%** of the sponsors, the value of the **support exceed even 169% in the baseline** and **266%** in the adverse scenario
- Figures suggest that a **significant number of sponsors are substantially impacted by their commitments to support the IORP, even under baseline scenario**

Distribution of sponsor support in the baseline and adverse market scenario, in % of market value of sponsor, all sponsors



Stakeholders need to be aware and discuss how to take this forward. The Own Risk Assessment of IORP 2 will make those discussions happen earlier in the process.

Dan Brown quotes in his latest book 'Inferno' Dante Alighieri and makes it the motto of the book

THE HOTTEST PLACES IN HELL ARE RESERVED FOR THOSE WHO
MAINTAIN THEIR NEUTRALITY IN TIMES OF GREAT MORAL CRISIS.

My take: actuaries should speak up

2019 IORP Stress Test

Valuation

- National balance sheet
- Common European approach – risk-free rates

Cash Flow analysis

- Including real-world expected return assumptions
- Covering full life-time of pension liabilities

ESG inventory

- Qualitative
- Quantitative

WHAT CAN BE EXPECTED NEXT?

IORP III?

Quotes (kept anonymous):

“Solvency for occupational pensions is back on the agenda of the Commission”

“Not immediately IORP III, but discussions with stakeholders will start”

“Review of IORP II is foreseen”

Anyway:

Both the Actuarial Function and the Risk Management Function

will play very important roles and all topics that I discussed.

Actuaries are very well positioned to combine those functions!