X CONGRESSO NAZIONALE ATTUARI
5/7 GIUGNO 2013 ROMA

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Groupe Consultatif Actuariel Européen

L'Attuario:
una professione in evoluzione al servizio della società

Financial Management of Pension Funds

Falco Valkenburg
Chairman Pensions Committee
Rome, 6 June 2013

Topics

Review IORP Directive – Solvency for Pensions

- How it started
- Quantitative Impact Study
- EIOPA's Report with Preliminary Results
- Next steps
- And a personal note as a short intro to my New Retirement Story
  - The people's perspective
  - Because models can't solve everything

EUROPEAN COMMISSION

MEMO

Brussels, 23 May 2013

Occupational Pension Funds (IORP): Next steps

Summary: Commissioner Barnier has indicated his intention to come forward with a proposal for a Directive to improve the governance and transparency of occupational pension funds in the autumn of 2013. At this stage, and as long as more comprehensive data is needed and Solvency 2 is not in force, the proposal for a Directive will not cover the issue of the solvency of pension funds. In light of the differing situations in Member States regarding retirement products and pension funds, it is necessary to continue technical work on the issue of solvency.

Statement by Internal Market and Services Commissioner Michel Barnier:

European society is ageing. Pension systems must adapt. It is not a simple matter. All Member States of the European Union are affected.

The Commission's White Paper on Pensions of 2011 suggested several approaches for dealing with an ageing society tackling comprehensively the three elements of retirement systems which exist in Europe, known as the **3 pillars**:

1) *Basic state pensions* which are part of national social security systems (an exclusive competence of Member States);

2) *Occupational or company pensions* (managed by pension funds, insurance companies or other systems, financed or co-financed by employers, who choose the fund manager);

3) *Personal pension products* which are non-compulsory and aimed at individuals.

Occupational pension funds are of growing importance in Europe, without being the only element of the second pension pillar, occupational pensions. For example, in some countries (France and Sweden for example) insurance companies are also active in occupational pensions, and other systems also exist

Occupational pension funds have enormous potential: they are part of the solution for meeting the challenge of an ageing society and they are essential for long-term investment and thus European growth.

The existing European Directive on occupational pension funds dates back to 2003. It aims to create a single market for occupational pension funds and to improve their functioning. However, those objectives have only been very partially achieved.

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Harmonisation of Solvency Requirements for Pensions is Deferred

Bad news, isn't it !?

Call for Advice from the European Commission

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It is about ***how*** to apply Solvency II for pensions

Not ***whether*** to apply Solvency II

Solvency II's framework

- can be seen at the Piazza di Pietra in Rome!

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)

Implementation for insurers was scheduled for 2014, but is delayed with an open end

Insurance Europe Conference, 1 June 2012

Commissioner Michel Barnier

"If we do not start the necessary reforms today, there will be no guarantee that the occupational pensions paid out in 10 or 20 or 30 years will be adequate. This is a matter of our common responsibility towards future generations."

"… we do not intend to apply all the Solvency II rules to occupational pensions institutions"

"We must remember that an occupational pension scheme is not an insurance policy"

"I have decided to take a few more months to finalise the revision. We therefore expect to table the revised Directive before summer 2013, rather than at the end of 2012"

"we will shortly be launching a green paper on this key issue of long-term investment"

http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/12/410&format=HTML&aged=1&language=EN&guiLanguage=en

NAPF Annual Conference, 17 October 2012

Gabriel Bernardino,

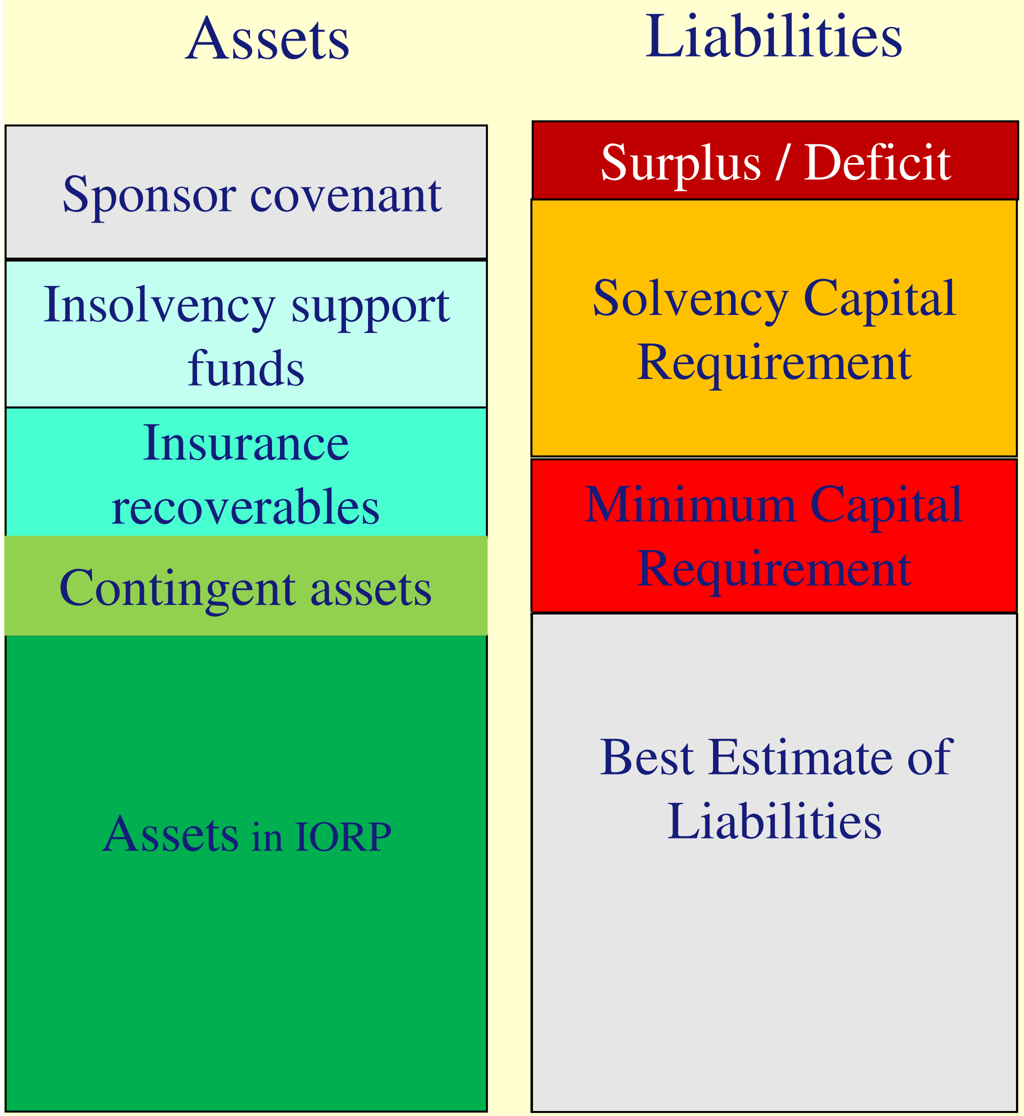
Chairman EIOPA

"Solvency II is a good starting point for further review of the IORP Directive"

- *EIOPA's advice … "should be considered as a whole package and not only a recommendation for capital requirements"*
    - *Governance and Information are as important*
- *Principles for capital requirements: Transparency, Comparability, Comprehensiveness → market-consistent*

https://eiopa.europa.eu/fileadmin/tx_dam/files/Press-Room/speeches/2012-10-17_NAPF_Annual_Conference.pdf

Holistic Balance Sheet (HBS)



Market consistent valuation

- both assets and liabilities

"Probability weighted average of future cash flows taking into account the time value of money"

Simplifications are allowed

- When proportionate to nature, scale and complexity of the underlying risk
- Establish that model-error is not material

Discount Rate

Level A, basically risk-free interest rate

- Swap rate until last liquid point
- Ultimate Forward Rate 4.2%
- Adjustments to reflect long-term nature of pension liabilities
  – Counter cyclical premium (CCP)
  – Matching adjustment

Level B, expected retu

Positi

nsion promises

itional pension promises

ion promises are somewhere in between

There is more than just one single interest rate curve
There is a single interest rate curve for each and every type of pension scheme!!

Options

Main text:	Options:
99.5% confidence level	97.5% confidence level 95% confidence level
Basic risk-free interest rate	Long-term nature adjustment Extrapolation of risk-free rate using 10 year convergence speed Extrapolation of risk-free rate using QIS5 convergence speed
Risk margin cost-of-capital	Risk margin adverse deviation No risk margin
Include pure discretionary and mixed benefits	Exclude pure discretionary benefits Exclude pure discretionary and mixed benefits
Include pension protection schemes as an asset	Include pension protection schemes as impacting on the default risk of the sponsor Exclude pension protection schemes
Exclude ex post benefit reductions	Include ex post benefit reductions
Nominal interest rate risk module	Interest rate risk module separating real interest rate and inflation risk
Equity dampener	No dampener Duration-based dampener
Sponsor support as asset	Sponsor support as ancillary own funds
Minimum capital requirement	
Level B best estimate of technical provisions: expected return on assets	

What results to expect?

- **7,776** combinations of outcomes!!
- **18** sets of combinations of options selected
- See pages 11 and 12 of Technical Specifications
- Many results will be “in the green”
- Many results will be “in the red”
- Resulting rich data to facilitate informed decision-making

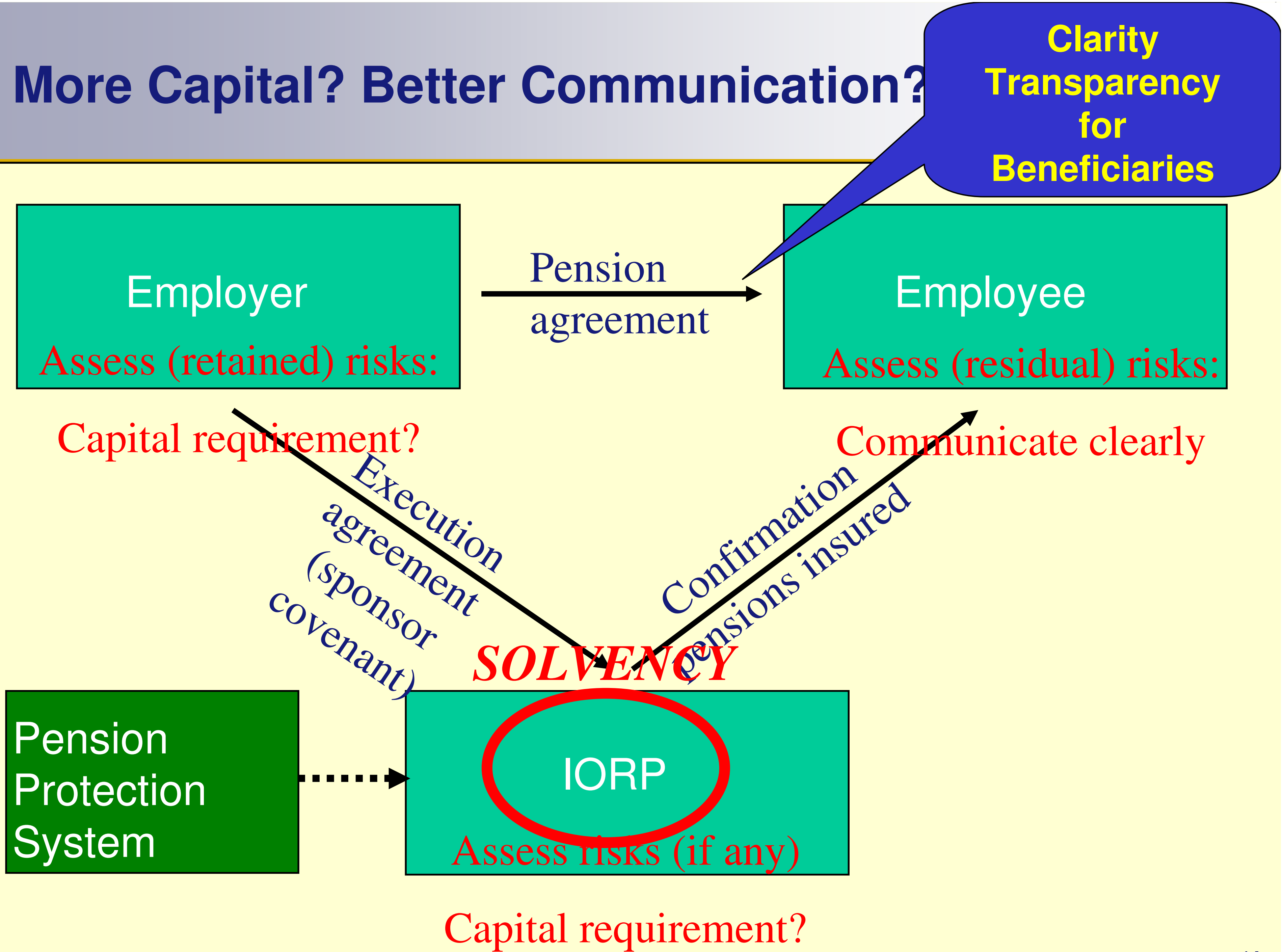
Macro-economic impact

- European Commission
  Joint Research Center
  - www.jrc.ec.europa.eu
    - *Serving society*
    - *Stimulating innovation*
    - *Supporting legislation*

Two workstreams:

1. Asset Liability Simulation
   - Impact of changing capital requirements
   - Impact of changing asset mix (shift towards bonds?)
   - Less capital avialable for (other) investments in economy?
   - Higher cost of capital?
2. QUEST III, global macro-economic model
   - Impact of shock in Cost of Capital in economy
   - Effects on households

More Capital? Better Communication?



Next Steps

- April 2013: preliminary results to European Commission
  - Is published on 9 April 2013

    https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/QIS/OPC/qis1/Outcome/EIOPA-BoS-13-021_QIS_on_IORPs_Preliminary_Results_for_EC_-_20130409.pdf
- July 2013: EIOPA's final report on QIS
  - Public event expected
- Q3 2013: Discussion Paper on Sponsor Support expected
- Autumn 2013: Commission's legislative proposal
  - On Qualitative requirements (Pillar 2)
  - On Disclosure requirements (Pillar 3)
  - *Quantitative requirements (Pillar 1) are deferred*

Quantitative Impact Study (QIS)

9 Participating countries:

- Germany
- Ireland
- Netherlands
- UK

On EC's request

- Belgium
- ~~France~~
- Portugal
- Sweden
- Norway

Voluntary participation

EIOPA-BOS-13/021
9 April 2013

QIS on IORPs

Preliminary Results for the European Commission

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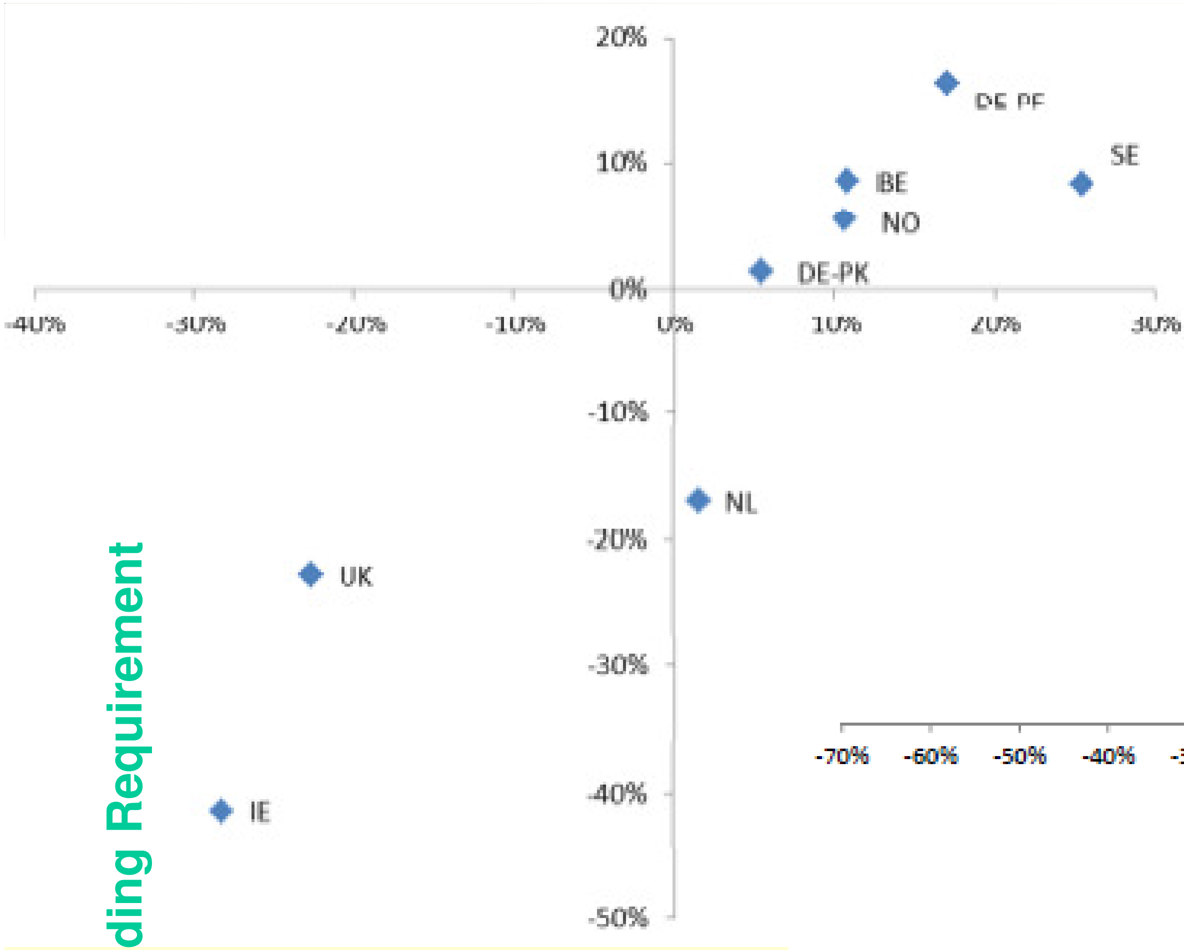

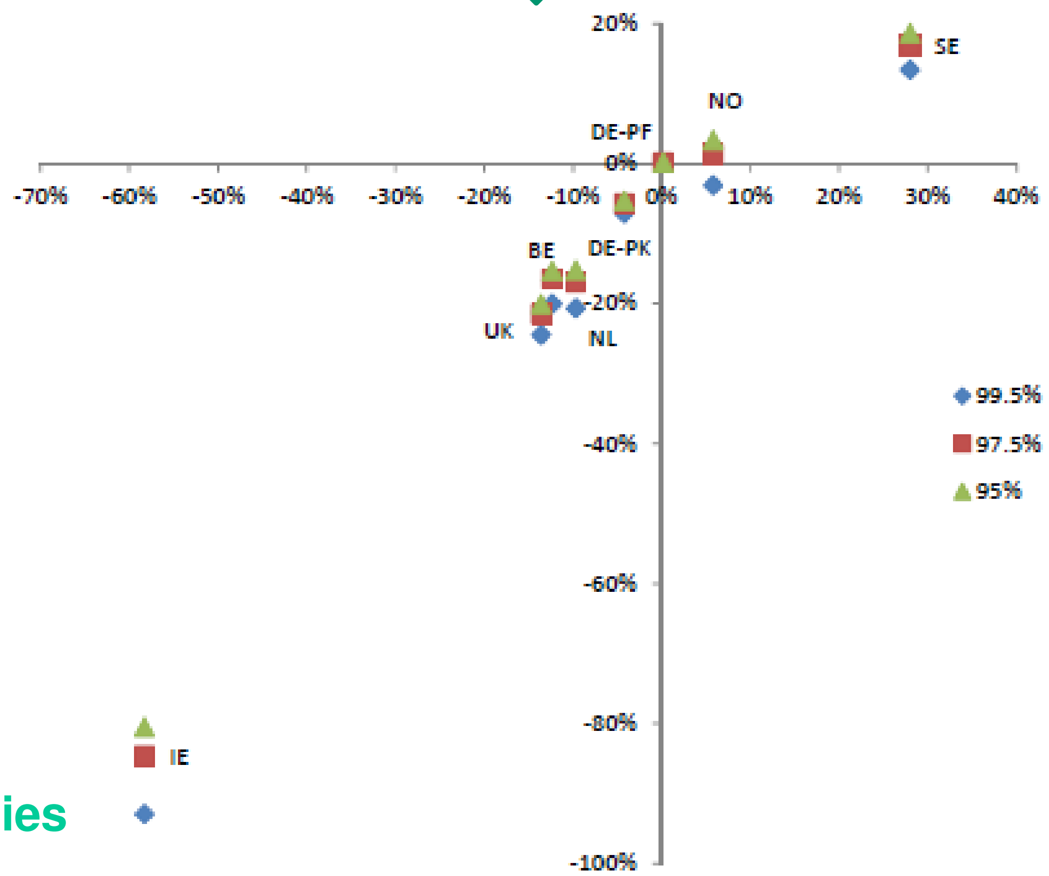

Surpus over Funding Requirement

Excess Assets over Liabilities

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FAZIOLI


FAZIOLI
00:05

Paolo Fazioli (1944)

Concluding remarks

A model will always cause debate

- It is never completely accurate

If we don't like the results we could

- Fight against the introduction of the model
  - And push financial issues forward (to the next generation)
- Assess whether the pension promise is sustainable
  - And address the issue together and find new ways forward

I believe that The New Retirement Story is about

"Creating a Life & Work You Love

and Never want to Retire from"