

# Keeping EU workers' pensions safe

## *AmCham EU position paper on Commission proposal to revise the Directive on activities and supervision of institutions for occupational retirement provision (IORPs)*

### Executive summary

With an ageing EU population, pension provision is an increasingly important aspect of maintaining a socially acceptable standard of living for EU citizens.

AmCham EU welcomes the Commission's decision to refrain from including in its proposal the quantitative measures based on Solvency II which caused considerable concern among stakeholders across the social partners. It does, however, share the views of a number of other organisations that the Directive as drafted could still lead to the imposition by delegated act of quantitative requirements, not least given the work being done by the European Insurance and Occupational Pensions Authority (EIOPA) aimed specifically at such measures.

Inappropriate regulation of pensions could not only result in the ability of pension funds to provide the long-term finance Europe needs, but also lead to the interests of pensioners which the Commission rightly seeks to protect, being damaged. Care will need to be taken in imposing other regulatory measures that might add unnecessary costs to the administration of schemes, which would directly lead to reduced benefits for pensioners.

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*AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled €1.9 trillion in 2012 and directly supports more than 4.2 million jobs in Europe.*

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The American Chamber of Commerce to the European Union (AmCham EU) welcomes the Commission's proposal for a revision of the IORPS Directive, and in particular the link made between this and encouraging long-term financing for industrial and infrastructure projects, for which pensions providers looking for long-term returns are well-placed to provide. These proposals need, however, to be consistent, and some elements of the IORPS Directive risk undermining the ability of pension funds to meet the objective of providing long-term financing for such projects.

As discussed below, the continued ability of occupational schemes to provide employees with a secure income in retirement is particularly relevant as the demographic and funding difficulties facing almost all state-funded (Pillar 1) pension schemes which the Commission's White Paper, (and which the Commission proposal does not address) become even more acute.

## **Pensions and Solvency II**

AmCham EU's members include many companies with occupational pension schemes in Europe that they stand behind financially to ensure that their employees have provision for an assured retirement. Very few of these are run on a cross-border basis, and therefore have not seen any great need for EU regulation. Since occupational pensions cover a differing proportion of pensioners' retirement income depending on which country they live in (in some cases only a small portion compared with state (Pillar 1) schemes, in others the bulk of it), finding an appropriate level of capital provision for all of the EU is likely to be difficult and could create inconsistent results. Since 23 countries have no or only limited occupational pensions provision, this effect will be concentrated on only 5 Member States, viz. Belgium, Germany, Ireland, the Netherlands and the UK

AmCham EU shares, however, the Commission's concern that these schemes remain viable and provide a reliable retirement income for company employees.. It was for this reason that many representatives of Member States, employers and trade unions voiced major concerns over the last three years about initial Commission ideas set out in the 2010 Pensions Green Paper and subsequent 2012 White Paper of applying to occupational pensions quantitative measures based on Solvency II. The immense upfront costs calculated by the affected pension schemes would have resulted in many schemes having to be wound up or the companies sponsoring them being unable to find the resources for investing in and running their businesses.

AmCham EU is therefore pleased that Commissioner Barnier has proposed a revision of the IORPS Directive that does not explicitly include measures that would directly mimic those of Solvency II, the implementation of which has in itself caused some major difficulty for the insurance industry.

We are, however, concerned that the provisions of articles 29 and 30 of the draft Directive, while explicitly saying that the delegated acts provided for in article 30 '*shall not impose additional funding requirements beyond those foreseen in this Directive*', could possibly result in a similar outcome to Level 1 imposition of quantitative measures.

The requirements for risk evaluation in article 29 lay out in some detail which risks need to be assessed, and require a risk assessment to inform the strategic decisions of the scheme. These will be added to in the delegated act foreseen in article 30. The cross-reference in article 29 to 14 technical provisions, which include a requirement that '*the minimum amount of the technical provisions.....must be sufficient both for the pensions and benefits already in payment ...and to reflect the commitments which arise out of members' accrued pension rights*', makes a link that might be construed as already imposing an implicit ratio of risk to capital. The Chairman of EIOPA, Gabriel Bernardino, writing in

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an article in October 2013, signalled that EIOPA was continuing to work on measures aimed at reinforcing this linkage: *'My goal is to continue the technical work in this area and present to the new composition of the European commission a tested proposal for a European risk-based prudential regime that appropriately reflects the specific reality of pension funds, including their long-term nature'*.

We note also the provision in recital 57 for a review of the Directive four years after entry into force, which is worded in a way that seems to assume already that there will be such a prudential scheme in any revision of the Directive thereafter. This recital should be worded in such a way as not to pre-empt any such review.

These elements seem to undermine significantly the assurance on no additional funding requirements in article 29. The imposition of a single EU measure of risk to capital could act perversely to undermine the viability of occupational schemes, and see pensioners worse off than at present, and in the worst case, the schemes on which they rely for their future retirement unable to continue to provide the benefits which they expect, or be curtailed completely.

### Recommendation

AmCham EU does not see that further quantitative measures are warranted and any language or measures that could be taken to imply this or offer an enabling provision of some sort should be removed or duly modified. In its work between now and the appointment of the new Commission, EIOPA should also examine carefully the consequences of imposing quantitative measures that might result in damage to the viability of existing occupational schemes, and could close off the possibility of new schemes being established to take up some of the considerable funding gaps threatening Pillar 1 state provision.

### Governance

Proper governance is an important element in ensuring the viability and management of pension funds in the interests of their members, and AmCham EU would support measures to ensure this, but appropriate to the size and the national circumstances of the scheme.

AmCham EU members are currently consulting their pension experts on the impact of the governance and reporting requirements laid down in the draft Directive, and will wish to reflect their views in more detailed comments later in the process of consideration of the Commission proposal.

A general point of importance that will require great care is that the cost of changing from existing national requirements on pension schemes to a single EU requirement will create additional costs, which will mean less money available to pay for members' pensions. Depending on assessments experts will need to make over coming months, there may be a need to look at alternative approaches to create the same outcomes. **Below are some initial comments that AmCham EU would wish to offer.**

In particular, we note that the provisions on governance in article 21 and following could add to costs of administering funds, and bar the appointment of, for example, employee representatives who may have considerable experience and a strong interest in protecting members' rights. As Pensions Europe has noted<sup>1</sup>, this goes far beyond the OECD guidelines on pension fund governance, which only requires the governing body to have such skills collectively rather than individually.

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<sup>1</sup> <http://www.pensionseurope.eu/iorp-directive>

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**Article 23 of the proposal as drafted suggests indirectly that non-EU nationals would not be eligible to serve as trustees. The requirement to prove that a trustee is not subject to personal bankruptcy needs redrafting to provide for this possibility of e.g. a US or other non-Member State national to provide a similar declaration.**

The very detailed provisions on benefits statements under Title IV are also likely to create considerable additional costs for funds, which will directly affect the benefits which the fund is trying to maximise for its members. Some of the provisions will also make these statements almost impossible to understand for most members of the schemes, and thus undermine the utility of the statement for those members.

The provisions on risk management and audit are particularly onerous. The requirement for internal audit, risk management and actuarial functions may be appropriate and manageable for larger schemes, but not for smaller ones. But as it is, the idea of sharing such resources with the employer sponsor of the scheme can lead to conflicts of interest is erroneous. If a company can provide such resources, but within the legal framework of a trust or similar, there should be no such conflict. The interests of the scheme and its members on the one hand and the employer on the other are closely aligned, as the consequences of an inappropriately managed scheme will lead to costs for the employer as well as the scheme.

Moreover, as national tax and social security provisions can be radically different, and cannot be harmonised by this Directive, the ability to draw on audit and other expertise from the countries in which the company operates provides the scheme with the appropriate information at a low cost. The draft Directive seems to ignore this point, and article 59 on prudential supervision reproduces the wording in a similar article in the Solvency II Directive. As noted above, national social and labour law already provides considerable protection already in ways reflecting the differing circumstances of each national pension environment. An EU Single Market measure is not the appropriate vehicle to harmonise such social and labour law, or the national tax law that feeds into those provisions.

In all this, it is important to remember that the costs of requiring these functions to be provided entirely within the scheme will impact directly on the benefits it can pay out to its members, whether under a defined benefit (DB) or a defined contribution (DC) scheme.

The burden on smaller schemes of such provisions will be particularly acute, and further thought is needed as to their treatment under the Directive. In addition, the cut-off for exempting smaller schemes of less than 100 members does not address the right target, and should rather look at the size of assets involved.

AmCham EU also sees the proposal to impose a single depository (presumably a custodian bank) for all plans both DB and DC as unnecessary and likely to have a negative impact, particularly on small DB schemes and DC schemes. While larger schemes might find this less problematic, the impact on smaller schemes, and many DC schemes would be additional cost (and thus less benefit to its members) and a concentration of investments with a manager who used the same depository. This could result in increased risk, and – contrary to the intent of the Commission package – make it almost impossible for schemes to invest in infrastructure projects, and to spread risk and maximise returns by looking for as diverse a portfolio of unitised funds, private equity or other vehicles where the assets need to leave the central depository.

AmCham EU agrees with the principle that beneficiaries should have as clear a statement of what they can expect to receive as a pensioner in an appropriate and understandable form. The proposal to require uniform specific benefits statements across the EU fails to recognise that differing tax and

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social security systems in different Member States will require different forms of statement. As it is, much of what the Commission seeks to standardise is either already provided for in national regulation aligned with national requirements, or is unlikely to add anything to the knowledge of the beneficiary, but will add to costs and reduce pensioner benefits.

This proposal will only affect a limited number of Member States (five out of 23); and the social partners in the Member States in question manage occupational pensions schemes collectively. Both of these aspects raise questions of how the proposal is consistent with the principle of subsidiarity.

The focus in the proposal on the rarity of cross-border schemes seems to ignore the fact that this has less to do with a lack of standardised governance and transparency regulation, but rather differing social, taxation and labour laws in Member States. As noted above, these cannot be addressed by this Directive, and would require a different legal base. Companies that have tried cross-border provision have found that the cost and administrative burdens of doing so – which this Directive would add to – are not balanced by any appreciable benefit to the scheme beneficiaries or its sponsors.

### **Recommendation**

AmCham EU will wish to return to this point when its members have a better appreciation of the likely impact of the proposals on governance and reporting. But a preliminary recommendation would be for the European Parliament and Council to look at the provisions in this proposal with a clear view of how far it is compatible with the principle of subsidiarity. They should therefore look at agreeing a set of outcomes that the Directive should seek to achieve, while leaving national regulators to lay down the measures designed to achieve these outcomes in the manner most appropriate to their national circumstances.

In particular, the provisions on governance and benefit statements should be streamlined to minimise the cost that pension fund members will have to meet directly out of their benefits of the scheme, and to be as comprehensible as possible to those members. We would also question how far any of the apparent barriers the draft Directive seeks to address to the creation of cross-border pension provision are the correct ones, and that the Commission proposal fails to recognise that demand for cross-border pensions is minimal. Thus these provisions seem to be a solution looking for a problem, and need not be included in the proposal with the level of detail the Commission suggests.

### **Conclusion**

AmCham EU shares the Commission objective of ensuring a sustainable and reliable system of occupational retirement provision. A monolithic approach to occupational schemes that are sponsored and sustained by employers for the benefit of their employees and have been built up and regulated in line with the conditions of the national market in which they operate, can risk the continued existence of such schemes. We therefore encourage the European Parliament and Council to look at achieving the positive objectives of the revised directive without creating negative outcomes for the pensioners that the Directive seeks to help.

Above all, unnecessary harmonisation of measures in a limited number of Member States in the hope of creating a demand for cross-border pensions provision will lead to unnecessary costs. These costs will at the very least be a burden borne by the beneficiaries, and at worst could hasten the decline in the provision to workers of occupational pensions schemes at a time when state provision is struggling to deal with the demographic challenges of an ageing society across Europe.