



# EURO PENSION BULLETIN

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## EDITORIAL

The current crisis leaves us with no choice but to rethink our orientation. In light of the turmoil of the last months, the prudential regulations for financial institutions in particular, but finally also those applying to pension institutions, are now put to the test, even if the concrete effects of the crisis in that respect vary from one country to another. The Commission took up the challenge and got the ball rolling for a new financial supervision structure, in particular by means of the "Larosière report" of March 2009 and the statements subsequent thereto. After the political agreement on the Solvency II Directive, debate is concomitantly underway to determine whether, and to what extent, supervision regulations are required at European Union level for occupational pension institutions. In light of the current situation, advocates of this approach are gaining ground, but it remains to be seen how and to what extent the complexity of occupational pension schemes will allow standardization at European level.

This discussion, however, has moved to the background the key problem that remains the genuine challenge for pension schemes, namely the increasing population ageing that will affect almost all European countries sooner or later. Pay-as-you-go pensions are still the most important pillar everywhere, and will remain so. We therefore need to use the opportunity afforded by the current debate to undertake overdue reforms, and avoid going back on already decided reforms against a backdrop of short-term objectives.

Hagen Hügelschäffer  
Original language: German

## Solvency II - EAPSPI contributes actively to the Commission's consultation

Last fall, the Commission launched a public consultation whether or not IORPs should be submitted to at least some principles of Solvency II. The consultation paper focused on two major aspects: on those IORPs that are covered by the scope of Art. 17 of the IORP directive (institutions underwriting the liability itself) and on those IORPs operating on a cross-border basis. The starting point of this consultation paper was a report of the Committee of European Insurance and Occupational Supervisors, CEIOPS, of March 2008 that had afterwards been revised by the Commission.

### Status quo of the discussion

Within the European Parliament the question was discussed controversially. The ECON-committee was competent for this issue and the rapporteur, Peter Skinner (SG) supported the idea of excluding IORPs of the Solvency II regime whereas the "shadow-rapporteur", Dr. Karsten Hoppenstedt (EPP-ED) was in favour of an extension to IORPs. Apart from the current Solvency II discussion, other members of the European Parliament are thinking about introducing new supervisory rules. MEP Icke van den Burg (NL), an expert in the field of supplementary pensions and member of the EMPL-committee recently invited representatives from second pillar pension institutions to introduce new ideas that take into consideration the main differences between the second and third pillar.

A further important actor in this field is CEIOPS (Committee of European Insurance and Occupational Supervisors). Initially the Commission had intended to ask CEIOPS for a call for advice whether or not Solvency II should be applicable to IORPs. Especially last year, the Commission had changed its point of view and decided to launch a broad-based consultation with the role of CEIOPS to provide supplementary studies.

### EAPSPI's view on Solvency II

EAPSPI has developed a position paper and contributed it to the consultation. In its position paper, EAPSPI stresses the following key messages:

EAPSPI would like to point out that the consultation would have been better based on a broader view allowing the Commission to get a complete overview of the various solvency rules of IORPs as well as different security mechanisms in Member States. Instead, the scope of the consultation is focused on pension schemes in some selected countries.

EAPSPI is of the opinion that there is a fundamental difference between IORPs and insurance undertakings in terms of pension products and of steering instruments. Therefore, EAPSPI believes that IORPs, i.e. institutions of the second pillar, should be treated differently to insurance undertakings of the third pillar since workplace (or occupational) pension provisions are fundamentally different to individual insurance contracts.

The IORP Directive already provides common minimum standards and its implementation was only achieved in 2007 in EU Member States. Therefore, further legislative measures to modify these rules are premature. A further harmonization of solvency rules for funded schemes on a European level is therefore not necessary at the moment.

With respect to the demographic evolution in Europe, EAPSPI is of the opinion that IORPs will be able to help solving future problems of the state-run first pillar schemes and that the IORP Directive will help to promote this development.

EAPSPI would like to mention that cross-border activities have had insufficient time to develop significantly since the implementation of the IORP Directive. Even if cross-border activities are expected to increase within the next years, EAPSPI does not believe that they will develop significantly among public sector pension schemes.

EAPSPI comes to the conclusion that, beyond the scope of this consultation, there are further common principles that are applicable both to funded IORPs (as far as funding and security mechanisms are concerned) and to unfunded IORPs (as far as only security mechanisms are concerned). These shared common principles can be outlined as follows:

- The main target of IORPs is the protection of the interests of the beneficiaries with regard to their pension commitment.
- In order to avoid any market distortions it is evident that in terms of funding and/or security mechanisms, the same rules should be applicable for pension products that are the same and delivered by insurance undertakings and by IORPs. This, however, requires the products to be truly comparable.
- In most countries, individual pension arrangements delivered by insurance undertakings are entirely different to pension products delivered by IORPs.
- The interests of the beneficiaries can also be ensured by other mechanisms than supervisory rules that are foreseen in the Solvency II directive. In particular, labour law provides a large degree of protection in many Member States. For this reason, labour law, and particularly collective labour law, may be called "consumer protection law in the field of occupational pensions".

The entire position paper is available on EAPSPI's website [www.eapspi.eu](http://www.eapspi.eu), in the "current issues" section. EAPSPI will continue to follow the discussion actively.

The Commission published the results of this consultation in a feedback statement in March 2009. In total, 60 national and EU stakeholders in the second and third pillar sector, but also other associations and institutions, took part in the consultation. Owing to the broad range of participants, it is not surprising that opinions are sometimes very different and that the Commission will have to deal with the complex issue of properly weighting these opinions before moving forward.

Moreover, the Council and Parliament have, in the meantime, agreed on a common position concerning the Solvency II Directive, which finally excludes occupational pensions from the scope of application

and which, within the framework of Article 17 § 2 of the IORP Directive (Directive 2003/41/EC), refers to the provisions of Solvency I in force up to now. Following a political trade-off, the revised text of the Directive includes a provision entitled "Duration based risk sub-module", applying to insurance companies only, the transposition of which is optional in the member states. According to this provision, insurance companies benefit from relief with regard to shareholders equity for their share portfolio (and only for this) compared with the other requirements of Solvency II, insofar as they offer pension products that benefit from tax incentives, establish a separate clearing pool for this type of product, restrict such operations to their country of accreditation and provided that the average term of liabilities exceeds 15 years.

Finally, the revised draft of the Directive includes an assignment for the Commission, namely to review the existing solvency rules for the second pillar in cooperation with CEIOPS, but taking differences with the third pillar into consideration.

Following the previous consultation of the autumn of 2008 and to comply with its assignment, the Commission undertook a public inquiry at the end of May. Within the framework of four successive round tables, the issue of whether and to what extent new solvency rules are to be drafted for occupational pension institutions, as the subject of the consultation, was addressed. As was already the case during the consultation, the viewpoints of the different stakeholders diverge. It is therefore to be expected that the Commission will need more time to settle the issue of the supervision of occupational pension institutions.

Eva Kiwit BVK/AKA & Hagen Hügelschäffer, EAPSPI  
Original language: English

### **Pension Funds and the Credit Crisis The experience within Europe**

A typical English grey spring day in London on 5 March rather reflected the mood of most speakers at the specially convened EAPSPI seminar to discuss members' experience of the market downturns during 2008 and how these are impacting on decisions which will have to be made over the short and medium term. It was an excellent learning opportuni-

ty for us involved with the LGPS in the UK, and if nothing else showed the benefits of "a trouble shared". There were breaks during the day but these merely moved the discussions from formal presentations to groups of individuals continuing to ask questions and exchange professional views.

Wolf R. Thiel chaired the day's proceeding and pointed out in his opening address on behalf of VBL a very envy inducing presentation, in that he was able to report a positive return of just over 7 % during 2008. Apart from some less positive news from Norway and Spain this stood out starkly from the quite considerable downturns experienced by other countries.

In absolute contrast the position in the Netherlands was particularly stark. At the end of 2007 pension funds like ABP has assets covering 140 % of their liabilities and had even had discussion as to how this surplus could be used to improve benefits or reduce contribution rates. But how things changed within the next 12 months? By the end of 2008 the fund only had assets to cover some 95 % of liabilities and serious issues of compliance with state funding requirements were having to be considered, since in the Netherlands funds are required to have recovery plans getting back to a position where assets cover at least 105 % of liabilities within 3 years. Discussions are ongoing in the Netherlands as to whether this recovery process can be shifted to five years to make the costs manageable. Because, quite clearly, during a period of recession employers simply do not have the cash to make significant increases in employer contribution rates.

There may have been some envy or concern that in the UK the LGPS funds can have recovery plans between 10-30 years recognizing the fact that local authorities - the "sponsors" of the Scheme - cannot become insolvent.

Typical experience was of losses of some 20 % plus on investments. In the UK the problem is made worse because the occupational pension makes up a higher proportion of pension replacement income and by the perception that the LGPS benefits (and those of other public servants) are guaranteed whilst at the same time private sector employers are closing their schemes. It is even worse in the private sector within the UK or that part of the LGPS which is third pillar and the scheme is defined contribution money purchase arrangement, where substantial losses in capital value have been seen. And at the same time low interest rates and low inflation mean that annuity purchase values are dropping.

But this gloom is compounded (the double whammy) by these capital reductions coinciding with the drop into recession throughout Europe. How can one enter into a stringent recovery plan when, as public bodies, cash is so tight and indeed reductions in expenditure are being sought? And is it necessary to undergo emergency recovery measures when one compares the liquidity (positive news) with solvency? And of course the solvency tests, which are linked to current market values of assets, in markets which have dropped by 40-60 % in such a short period of time raise fundamental issues as to just how one measures pension liabilities. Marking the cost against current market leads to distortions, and just how long can all institutions follow the suggestion that sitting on our collective hands and not making knee jerk reactions which simply create other problems of potential under provision in the longer term. Such under provision would then lead to risk being borne by the member state, so a short term saving could generate substantial long term extra costs.

The seminar did not find or propose solutions to many of the issues identified. But that was not the purpose of the seminar. Identifying the problems and being able to discuss them reasonably and rationally shows the strength of EAPSPI, in that it can call on such a wealth of knowledge and experience. More work on this subject will follow no doubt during this year. As European economies eventually move out of recession some of the issues can be forced back into the Pandora's box from which they escaped. If economies do not recover, then perhaps worrying about pension financing becomes a completely separate dimension. For the moment, sitting on one's hands and avoiding knee jerk reactions to a singular set of economic circumstances might be the best, and only, answer in the short term. But all institutions need to keep the position under constant surveillance.

Brian Town, CLG  
Original language: English

### The financial emergency measures in the Public Interest Act 2009

The purpose of this Act is to introduce a number of financial emergency measures in the public interest. These are, mainly,

- the making of a new deduction from the remuneration of public servants who are members of a public service pension scheme or who have an analogous arrangement and
- provisions to allow public bodies to reduce the professional fees paid by them to external service providers.

The Act was introduced in the context of the priority to be given to the stabilisation of the public finances. The Act provides that savings accruing from these measures will be remitted to the benefit of the Exchequer.

Under the Act, the pension-related deduction is being made with effect from 1 March 2009 in respect of remuneration paid to public servants from that date.

The criteria for being covered by the pension-related deduction are that a person is a public servant as defined in the Act and -

- (a) is a member of a public service pension scheme as defined in the Act or
- (b) is entitled to a benefit under such a scheme or
- (c) receives a payment in lieu of membership in such a scheme.

The deduction rates set out in the Act are as follows:

- First € 15,000 of income - 3 %
- Next € 5,000 of income - 6 %
- Income above € 20,000 - 10 %.

However, these rates have since been modified and the new rates are as follows:

- First € 15,000 of income - exempt
- Next € 5,000 of income - 5 %
- Income from € 20,000 to € 60,000 - 10 %
- Income above € 60,000 - 10.5 %.

The deduction will not to be paid into a pension fund or pension reserve fund but will be remitted for the benefit of the Exchequer. Additional pension benefits do not arise as a result. The existing rate of pension contributions will continue to apply in addition to this new deduction.

### Incentivised scheme of early retirement in the public service

To reduce the public service pay bill and facilitate a permanent, structural reduction in the numbers of

staff serving in the civil service, local authorities, the health sector, non-commercial state bodies and certain other areas of the public service, the Government in its April 2009 Budget announced the introduction of an early retirement scheme for certain civil and public servants.

The reduction in numbers arising from the early retirement scheme is intended to contribute significant continuing savings to the Exchequer, while Departments and agencies will be taking action to rationalise and restructure their operations so as to minimise the effects on service delivery as far as practicable.

The scheme will provide that an eligible civil or public servant aged 50 or over may retire from the public service without actuarial reduction of pension entitlements. Ten per cent of the relevant lump sum will be payable immediately with the balance paid later at the normal retirement age of 60 or 65, as appropriate, without actuarial reduction and subject to the taxation provisions in force on the date the application for early retirement was approved.

The scheme will be subject to local management arrangements and controls to ensure that its operation does not undermine the effective delivery of services to the public. Those leaving under the scheme will not be replaced except in specific cases or circumstances sanctioned by the Department of Finance.

The scheme will be open to applications from 1 May 2009. Its continued availability will be reviewed before the end of the year in the light of experience.

Damian Smyth, Public Authority Pension Services  
Original language: English

### Asset Management - EAPSPI's new working group has started its activities

At its last General Assembly in Helsinki on 8 October 2008, EAPSPI's members agreed to create a new working group on asset management. The group is intended to be a useful forum of experts for an in-depth exchange of best practise in order to help members to improve their asset management and to learn about the challenges and solutions for other institutions. The initiative was based on a proposal of

the Board of Directors at the beginning of 2008, after the subprime crisis burst but some time before the worsening of the current financial crisis. Therefore, the working group and its activities are particularly important for funded schemes that are nowadays faced with sometimes considerable losses over a short period. The group's work also concerns those pay-as-you-go schemes that are accumulating reserves as financial buffers or that intend to move to a funded system in the medium- or long-term. But the scope of the working group's activities is not restricted to the sole issue of assets even if the name of this working group might lead to this conclusion. The ongoing discussion about new supervisory rules - either in the context of the Solvency II Directive or of the revision of the IORP Directive will have to be observed and analysed thoroughly by this working group.

After its formal creation, the group met once at the beginning of January 2009, notably to get an overview of the particular features of the respective pension schemes and to define its future strands of activities. Although EAPSPI's member organisations all provide pension services for the public sector, these services vary between basic schemes (first pillar) and supplementary schemes (second pillar). Their activities reflect the diverse nature of the schemes: defined benefits and defined contributions; some are fully funded, others operate on a pay as you go basis, others are hybrid schemes or are gradually putting in place a system of funding. In terms of prudential supervision, some members are supervised as insurance undertakings, others benefit from a long-standing tradition of pension fund supervision in their countries - some of them being supervised by designated authorities while others are subject to supervision by ministries- while others are part of a recently emerging pension fund sector. As far as the number of affiliated members, there are national schemes with millions of members and much smaller regional schemes. Furthermore, each country has its specific organisation of the public sector, which means that the number of civil servants varies widely from one country to another, and the system is more or less centralised according to the territorial organisation (federal, regional, etc.) and history of the country. These differences affect *inter alia* asset/liability management, asset allocation, eligible assets, prudential supervision, solvency requirements and accounting rules. Despite this diversity, the members of EAPSPI face the same basic challenges (e.g. maintaining financial equilibrium beyond the short-term); they invest in the same markets, place their assets in similar investments and pay close attention to resources devoted to this function.

Starting from these considerations, the working group first defined the following areas that are to be debated although every member is aware of the fact that these issues can only be handled in an exhaustive manner step by step and not within a short period. These strands are:

- Socially Responsible Investment (SRI)
- Strategic Asset Allocation Process
- Asset management techniques
- Risk management
- Certain overarching issues (e.g. OECD and other guidelines on Pension Fund Asset Management; Prudent person principle)

The turmoil on the financial markets has perhaps brought forward the need to consider pension investment in a way that is consistent with the long-term aim and horizons of our institutions. These different areas of work will allow the group to explore specific features of the role of EAPSPI members as long-term investors. Especially in view of the current crisis, these issues will provide sufficient material for future meetings. Therefore, the activities and the expertise of this new working group are expected to be of high practical relevance for EAPSPI members. Indeed, the participation of many members of the working group as speakers at the seminar in London on 5 March: "*Pension funds and the credit crisis – The experience within Europe*" demonstrates the importance given to the subject. Against this background, the EAPSPI-seminar on 16 October, immediately after the next General Assembly the day before, will be devoted to the question of how public sector pension institutions are dealing with the current challenges. The Asset-management working group will therefore once more provide input and hopes to stimulate the information exchange within the association.

Tim Pullman, CDC & Hagen Hügelschäffer, EAPSPI  
Original language: English

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