LATEST REGULATORY NEWS FOR PENSION INSTITUTIONS
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Pension institutions play a crucial role in a context of aging European population. In effect, the old-age dependency ratio in the EU 28 will almost double, from 28.8% in 2015 to 51% by 2080, meaning that every 100 economically active people will support 51 retired persons.

All OECD countries have a “three-pillar” structure for pension organisation, the share of each pillar varying from one country to another in the total income that is received by retired people. However, the regulatory framework is very specific to each country.

Today, all pillars considered, more than 10% of the EU GDP is distributed by pension institutions.

In some Member States, Pillar 1 is predominant while Pillar 2 is inexistant or weakly developed. For those countries, this means a growing burden on public spending when the old-age dependency ratio increases and the development of a robust occupational pension fund sector is seen as an efficient way to solve the pension challenge.

According to a survey run by the EC Social Protection Committee, the share of occupational and statutory funded pensions in total gross theoretical replacement rates should radically change between 2006 and 2046 in a number of countries.

This white paper will present an overview of regulatory initiatives in the EU over the last twelve years, focusing more specifically on IORP II, the latest initiative in relation to the Institutions for Occupational Retirement Provision (IORP).
Several initiatives related to pension organisation have been taken by the European Union over the last 15 years.

- June 2003: IORP I
- April 2004: Coordination of social security systems
- November 2008: Start of Solvency I revision
- November 2010: Creation of EIOPA

2003 - The first Directive on Institution for Occupational retirement provision

In 2003, the IORP Directive was adopted, establishing the European prudential framework for occupational pension funds, and setting principles designed to secure the retirement income of Europe’s citizens provided by IORPs. In particular, IORP I stated that pension funds should:
1. have sufficient assets to cover pension commitments;
2. possess professionally qualified governing bodies, sound administrative procedures and adequate internal control mechanisms;
3. be transparent towards plan members by clearly communicating the target level of benefits, risk exposure and investment management costs.

IORP I also enabled the establishment of pan-European pension funds, allowing the management of pension schemes of employees in different member states.

2004 - The coordination of Social Security Systems


The provisions of this Regulation apply to all the traditional branches of social security and hence retirement benefits. Three main points were related to pensions:
1. All Member States in which a person has been insured must pay an old-age pension when the insured person reaches the age of retirement. The calculation of the amount of the benefits takes into consideration all the periods completed in another Member State.
2. Rules were set concerning the way in which the competent institutions calculate benefits and establish rules to prevent overlapping.
3. If a worker is entitled to benefits in several EU countries, the total amount of the benefits must not be less than the minimum provided for in the legislation of his/her Member State of residence. If the state of residence has a minimum pension scheme. Otherwise, the institution of the Member State of residence must pay compensation.

2011: the European Insurance and Occupational Pensions Authority (EIOPA)

Following the financial crisis of 2007 - 2008, the European Union decided to review the financial supervision framework. This led to the creation of three new European Authorities with the core responsibility of ensuring the stability of the financial system:
- the European Securities and Markets Authority (ESMA)
- the European Banking Authority (EBA)
- and the European Insurance and Occupational Pensions Authority (EIOPA)

One of them, EIOPA, is more specifically in charge of Occupational Pensions, in addition to the insurance sector.

In 2015, EIOPA published several important documents and launched significant initiatives:
- Publication of a report on costs and charges of IORPs, highlighting the necessity for greater transparency and clarity over who bears IORP costs and charges.
- Consultation on the creation of a standardised pan-European Personal Pension Product (PEPP) with the objective of promoting a multi-pillar approach across the EU and ensuring a level playing field for providers.
- Publication of a report focusing on the evolution of cross-border IORPs in the European market.
- Launch of the first stress tests assessing the resilience of IORPs to adverse market scenarios in 17 European countries (the objective is to cover at least 50% of relevant national markets).
Twelve years after the adoption of IORP I, it was stated that it was more critical than ever to ensure an appropriate regulatory framework allowing the development of safer and more efficient occupational pensions.

**OBJECTIVES**

With the revision of the IORP Directive (which will lead to IORP II), the EC follows three specific objectives:

1. to enhance the protection of members and beneficiaries of pension funds through the improvement of governance rules for institutions;
2. to provide clear and relevant information to members; and
3. to remove the remaining prudential barriers to cross-border schemes.

IORP II does not apply to the following institutions:

- Institutions managing social security schemes covered by certain EU Regulations.
- Those operating on a pay-as-you-go basis
- Companies using book reserve arrangements
- Those covered by other EU prudential legislation, such as the Solvency II (exceptions), MiFID, AIFM, CRD IV and UCITs Directives
- Those where employees have no legal right to the benefits and any assets can be redeemed by the sponsor at any time

Member States can also choose not to apply IORP II provisions to IORPs with fewer than 100 members and to IORPs for which retirement provision is guaranteed by a public authority.

Particular attention should be given to Article 4 related to insurance companies operating an occupational retirement provision business. A transition period is in effect until 2022, whereby such activity can be ruled either by the applicable rules of Solvency II or by applicable IORP II provisions, based on the option selected by the Member State.

If the Member State chooses to be ruled by IORP II provisions, all assets and liabilities corresponding to the said business shall be ring-fenced, managed and organised separately from the other activities of the life insurance undertakings, without any possibility of transfer.

**TIMELINE**

The final draft proposal for the IORP II Directive (dated 28 November 2014) is currently being negotiated with the European Parliament (EMPL (Employment and Social Affairs) and ECON (Economic and Monetary Affairs) committees).

Once adopted, Member States will have 18 months to transpose it into national law after publication in the Official Journal of the European Union.

**FOCUS ON IORP II KEY PROVISIONS**

1. Enhancing the protection of members and beneficiaries of pension funds

The IORP II Directive aims at enhancing the protection of members and pension fund beneficiaries by combining:

- Quantitative requirements (as expressed in Articles 14 to 20);
- Governance Principles (Articles 21 to 32);
- Specific rules related to outsourcing and investment management (Articles 33 to 34);
- A reinforced role for Depositary banks (Articles 35 to 37).

We will comment on some of the significant new articles below.
New governance principles

Article 21 states that the supervisory body of an IORP has the ultimate responsibility under national law for compliance with the laws, regulations and administrative provisions adopted pursuant to the IORP II Directive.

Article 22 asks for an effective system of governance and an adequately transparent organisation. Written policies shall be established in relation to risk management, internal control, internal audit and, where relevant, actuarial activities and outsourced activities, and the IORP shall ensure that those policies are implemented. Those written policies shall be subject to prior approval by the supervisory body of the IORP and shall be reviewed at least every three years or be adapted in case of any significant change in the system or area concerned. Last but not least, the IORP shall be effectively run by at least two persons. Unless expressly approved by the competent authorities of a Member State after an assessment process, an IORP cannot be effectively run by a single person.

Article 23 requires the competent authorities of Member States to ensure effective procedures and controls to assess whether the persons who effectively run an IORP or have key functions can demonstrate the appropriate repute and integrity as well as adequate professional qualifications, knowledge and experience on a collective basis.

Article 24 focuses on remuneration policies and requires institutions to establish and apply a sound remuneration policy for all those persons who effectively run the institution, those who perform key functions and other categories of staff whose professional activities have a material impact on the risk profile of the institution and of the pension schemes operated by it. Moreover, institutions shall disclose relevant information regarding the remuneration policy, at least to members and beneficiaries on request.

Article 25 requires institutions to have a risk-management function, an internal audit function, an internal control function and, where applicable, an actuarial function.

Article 29 relates to the obligation for each IORP to run a “Risk Evaluation for Pensions” and to document it in a comprehensive manner. This risk evaluation shall be performed at least every three years or without delay following any significant change in the risk profile of the institution or of the pension scheme operated by the institution.

Specific rules related to outsourcing and investment management (Articles 33 to 34)

If outsourcing of key functions is possible, the IORP will remain fully responsible for compliance and the need to notify, in a timely manner, the competent authority about this outsourcing as well as any further development. Whatever the activity outsourced, an IORP needs to enter into a written agreement with the service provider and to ensure the proper functioning of the outsourced activities through the on-going monitoring of the activities of the service provider. The directive also stipulates that National Competent Authorities shall be able to request information from institutions and from service providers about outsourced key functions or any other activities at any time.

Member States shall not restrict institutions from appointing investment managers established in another Member State and duly authorised for this activity (Article 34).

Need to appoint at least one Depositary unless an equally safe arrangement is possible (Articles 35 to 37)

Article 35 differentiates between plans where members fully bear the investment risk and the others.
2. Providing clear and relevant information to members and beneficiaries

Title IV of the Directive (Articles 38 to 58) details the nature and the extent of the information to be provided to members and beneficiaries.

Article 39 details the key facts members and prospective members shall be informed about before and when contributing to an occupational pension scheme. They include:

- the conditions regarding guarantees of a given investment performance or of a given level of benefits, if any;
- the mechanisms protecting accrued entitlements or benefits reduction mechanisms, if any;
- the options available to members in receiving their retirement income;
- where members bear investment risk or can take investment decisions, the historical series of investment returns obtained at least during the last five years and the structure of costs borne by members.

In addition to that, IORPs shall make the following information available upon request:

- Annual accounts and annual reports;
- Statement of investment principles;
- Information on actuarial assumptions used for the pension benefits statement (annual rate of nominal investment returns; annual rate of inflation; trend of future wages, etc.)

In terms of periodic information, the IORP will need to publish free of charge a “Pension Benefit Statement” (PBS) to each member at least once every twelve months, with a clear indication of the retirement age or the date when retirement benefits will start to be received.

The PBS will mix information related to each member with information related to the pension scheme, with different requirements between Defined Contribution (DC) and Defined Benefits (DB) Schemes:

For DC Schemes:
- the contributions paid by the sponsoring undertaking and the member into the pension scheme over the past twelve months;
- the capital accumulated by the member;
- the expected amount of the capital accumulated by the member at the estimated retirement age or the estimated date when receiving retirement benefits or indication of where these projections are provided;
- the total amount of the costs borne by members;
- details of investment options;
- information about the risk and return profile: an explanation of investment risks which are materially relevant as well as a brief explanation of the actual returns.

For DB Schemes:
- the accrued individual entitlements (net of all costs);
- target benefits at retirement age or indication of where the associated projection is provided.

3. Removing barriers to cross border schemes

According to a recent EIOPA report, in June 2015 there were 76 active cross-border IORPs in eight countries having activities in 17 host countries, a great part of them being associated with corporate companies. Cross-border IORPs account for close to €54Bn of assets representing less than 2% of total IORP assets (€3,680Bn).

(1) Sources: EIOPA, IORP II consultation report, 2015 Market development report on occupational pensions and cross-border IORPs.

In article 12 and 13, IORP II sets up new rules aiming at facilitating the cross-border activity of IORPs as well as facilitating pension schemes cross-border transfers.
POINS UNDER DISCUSSION

Aware of the necessity of developing supplementary pension savings, partly because of the forecast decline in public pension benefits, Member States are broadly positive about proposed modifications to the IORP Directive and the associated objectives in terms of transparency and governance, and generally about the strong will of the European Commission to ensure higher security around retirement at European level. Nevertheless, some hesitations are collectively mentioned and should hence be followed with caution as negotiations are ongoing on the following elements.

1. The possibility of institutions investing in assets not negotiated on regulated markets
   If this approach is justified by the diversification of investment risks and the achievement of performance objectives suitable to long-term investment objectives, some have insisted on the need for caution, because those investments are exposing members and beneficiaries to higher risks.

2. Uncertainties on the role of social partners in IORP II general provisions concerning governance measures to be taken.
   There are a number of objections to the setting up of a rule aiming at the exclusion of voluntary employees or other representatives of social partners appointed to sit on the executive board. Simultaneously, there is insistence on the fact that the Directive shall take into account the essential role of social partners in the development and management of pension plans, but also the important role of national legislation in social security and labour law.

3. Worries on the perspective of a final result setting an inefficient “one size fits all” model.
   Brian Hayes, rapporteur for the opinion of the ECON committee, insisted that the aims set by the Commission cannot be achieved with a “one size fits all” approach. He justifies this opinion by noting the numerous fundamental differences between Member States’ pension plans as well as between different supplementary pension plans. Likewise the EESC (European Economic and Social Committee) has underlined that pushing convergence of supplementary pension plans can be costly and may in fact lead not to their development but to their progressive disappearance.

GLOSSARY

- **Beneficiary**: a person receiving retirement benefits.
- **Book reserve arrangements**: Sums entered in the balance sheet of the plan sponsor as reserves or provisions for occupational pension plan benefits. Assets are not legally or contractually the pension plan assets.
- **Defined Benefit (DB)**: Plans in which the level of pension benefits promised to participating employees is guaranteed.
- **Defined Contribution (DC)**: Occupational pension plans under which the plan sponsor pays fixed contributions and has no legal or constructive obligation to pay further contributions to an ongoing plan in the event of unfavourable plan experience.
- **EC**: European Commission.
- **ECON**: European Parliament Committee on Economic and Monetary Affairs.
- **EESC**: European Economic and Social Committee, consultative body of the European Union.
- **EMPL**: European Parliament Committee on Employment and Social Affairs.
- **Funded system**: plans that accumulate dedicated assets to cover the plan’s liabilities.
- **IORP**: institutions for occupational retirement provision.
- **Member**: a person, other than a beneficiary or a prospective member, whose current or past occupational activities entitle or will entitle him/her to retirement benefits in accordance with the provisions of a pension scheme.
- **Pay-As-You-Go (PAYG)**: today’s contributions are used to finance today’s pension benefits.
- **CRD IV**: Capital Requirements Regulation and Directive (CRR/CRD IV). The aim of CRD IV is to ensure that banks hold enough financial resources to cover the risk associated with their business.
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