

# Efficient & effective private pension provision



**Ms. Chris VERHAEGEN, Secretary General**

**National Private Pensions Conference**

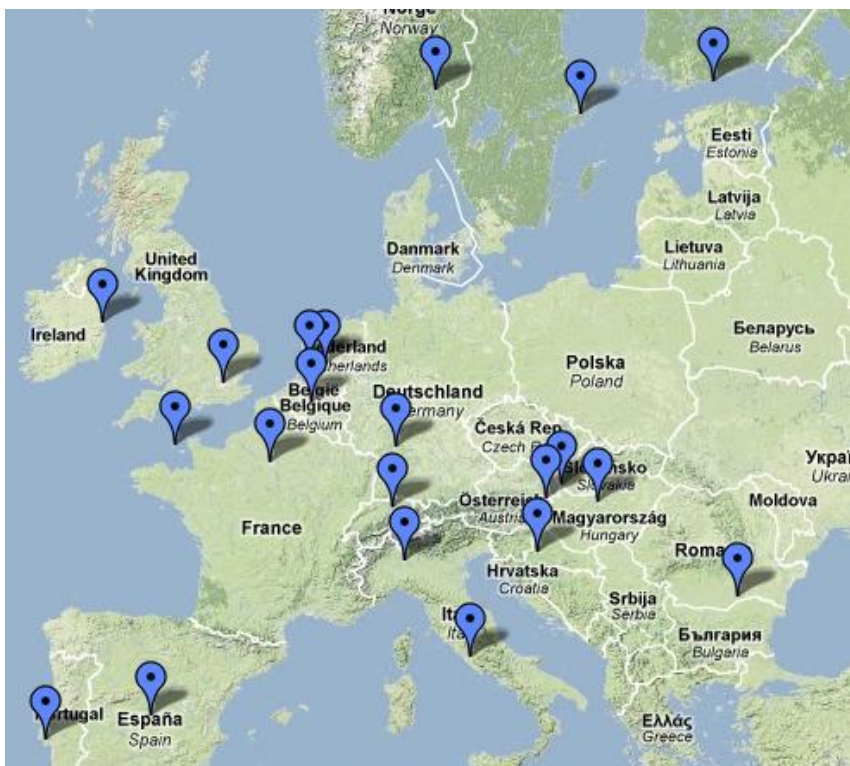
**14 October 2009, Bucharest**

# Key messages



- EFRP is the leading voice on private pensions in Europe
- Pension institutions were less affected by crisis than other financial institutions – yet, supervisory overhaul will also affect pension institutions
- To deliver promised returns pension funds need a stable and supportive regulatory environment
- Guarantees are extremely costly, especially at short time horizons
- Incoming Commission may work on pensions

# The EFRP



## 28 Member Associations

15 EU Member States

(EU-15 – DK – EL – LUX + HU + RO + SK)

5 non-EU

(CH, Guernsey, HR, IS, NO)

EFRP core Membership: **workplace pension providers**

**Membership represents € 3,7 trillion for future pension payments of 77 million European citizens !**

# EFRP Mission Statement



## EFRP stands for:

- **Affordable** pensions for large sections of the population
  - helping to maintain **living standards** in retirement
  - that provide a degree of intra- and inter-generational **solidarity** and, which are
  - administered through **funding institutions**
  - which can benefit from a **European passport**
- taking into account:*
- the principles of **subsidiarity** and **national diversity**

# EFRP CEEC Forum (1)



- **9 Members:**

Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Romania, and Slovak Republic

- **Role:**

- Discussing issues common to Central & Eastern European pension systems
- Exchanging views on experiences in pension systems
- Debates may result in action points to be taken to EU level in Brussels
- Promoting common European values in pension systems

# EFRP CEEC Forum (2)



## Facing up to the challenges



## Report of CEEC Forum conference in Budapest – 24 March 2009

- Investment restrictions
- Pay-out phase
- Supervision
- Impact of the financial and economic crisis
- Country reports

## Financial & Economic turmoil (1)



- no liquidity problems: pensions continue to be paid out
- deterioration of the financial position of **DB schemes** due to:
  - falling equity markets
  - low interest rate environment
- BUT recovery can be achieved by:
  - pension cut collectively shared
  - sponsor contribution
  - recovery plans
  - financial market upturn

## Financial & Economic turmoil (2)



- **DC schemes** face different risks: employees
    - *>10 years away from retirement*: business as usual
    - *<10 years to retirement*:
      - adverse annuitisation due to low interest rate
      - severely downsized pension savings pot
    - *just after retirement*: devaluation of assets portfolio if paid out as a lump sum
- BUT improvement can be achieved by hybrid design
- lifecycle funds (90% in the UK) - collective DC (NL)
  - minimum return over total accumulation phase (BE, DE) **≠ annual minimum return or guarantee**
- and by
- financial market upturn
  - deferral of annuitisation

## Towards a new financial supervisory system



- Two new pillars are proposed for a new supervisory structure in Europe
  - **Macro level:** European Systemic Risk Board
    - To monitor potential threats to financial stability that arise from
      - macro-economic developments
      - developments within the financial systems as a whole
  - **Micro level:** European System of Financial Supervisors
    - National supervisors with 3 new authorities to safeguard financial soundness at the level of individual financial firms
      - EBA: European Banking Authority
      - ESMA: European Securities and Markets Authority
      - **EIOPA: European Insurance and Occupational Pension Authority**
        - » EIOPA will replace CEIOPS

## EIOPA – proposed tasks & powers



- To ensure single set of harmonised rules
  - Binding technical standards
  - Interpretative guidelines
- To ensure consistent application of EU rules
  - Facilitate dialogue between national supervisors in case of disagreement
- Ensure a common supervisory culture and consistent supervisory practices
- Full supervisory powers for some specific cross-border entities
- Ensure a coordinated response in crisis situations
- Collect micro-prudential information
- Undertake an international role (e.g. cross-Atlantic, IMF)

## Research indicates...

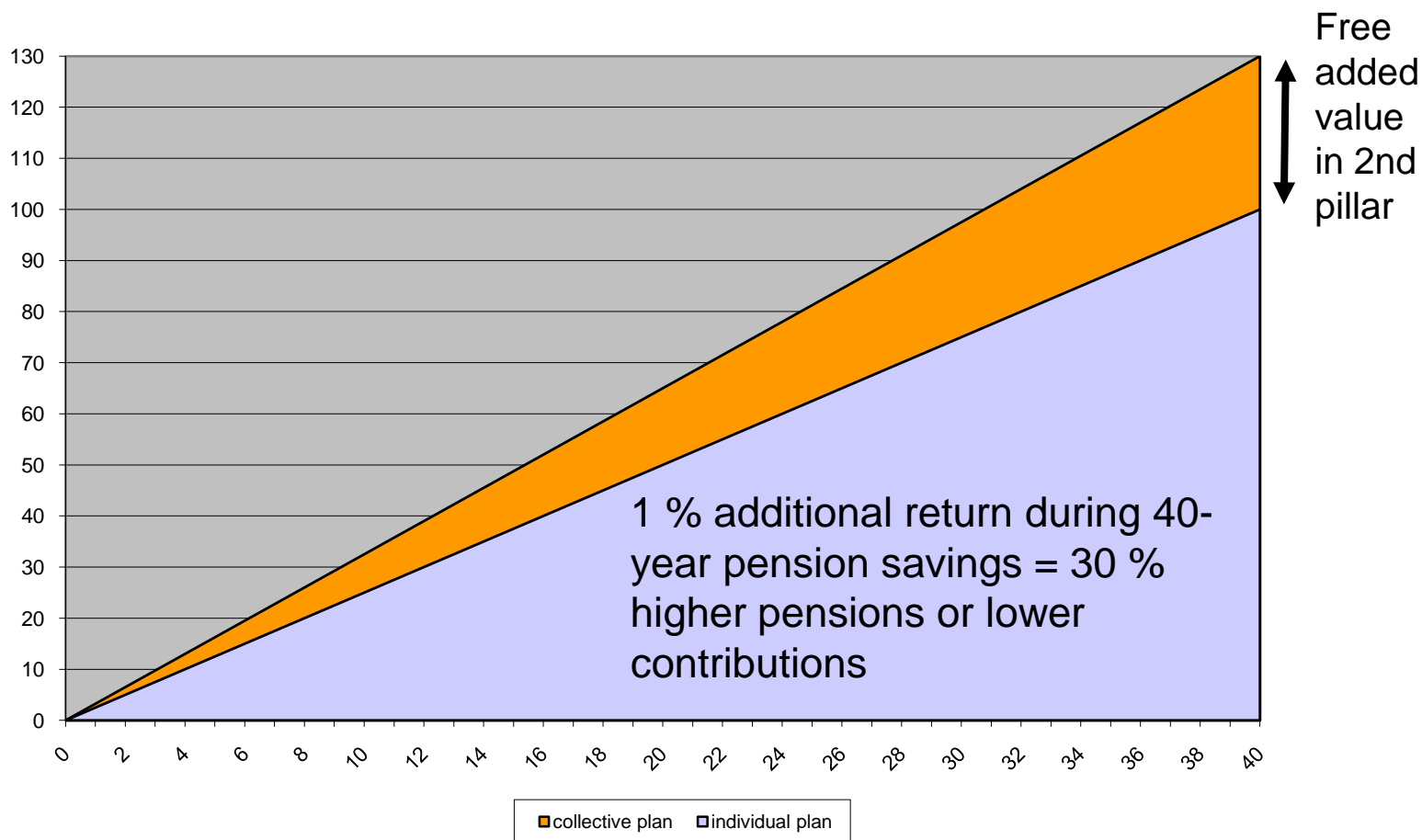


1. For an ageing society cost efficient management of pension savings is paramount to make pensions affordable
2. Small differences in returns of long term savings make huge difference
3. Individuals are not interested in pension planning
4. Individuals make wrong and unhelpful investment decisions
5. Guarantees are very costly at short horizons

# Capital growth



Capital growth



# Behavioural finance



- individuals do not satisfy the neoclassical assumption of rationality
- hyperbolic discount rate – people value short term consumption prospects much higher than long term consumption prospects

Result : too low savings in households

# Choice



- individuals:
  - are not able
  - do not wantto make their own pension decisions
  
- individuals make wrong and unhelpful investment decisions
- Solution → professional management in collective investment funds
- But: too much choice of funds is counterproductive (ex<sub>14</sub> Sweden)



# Guarantees (1)

1 year – median return

5 year – median return

10 year – median return

No guar.

5.5%

5.5%

5.5%

Capital guar.

0.1%

3.9%

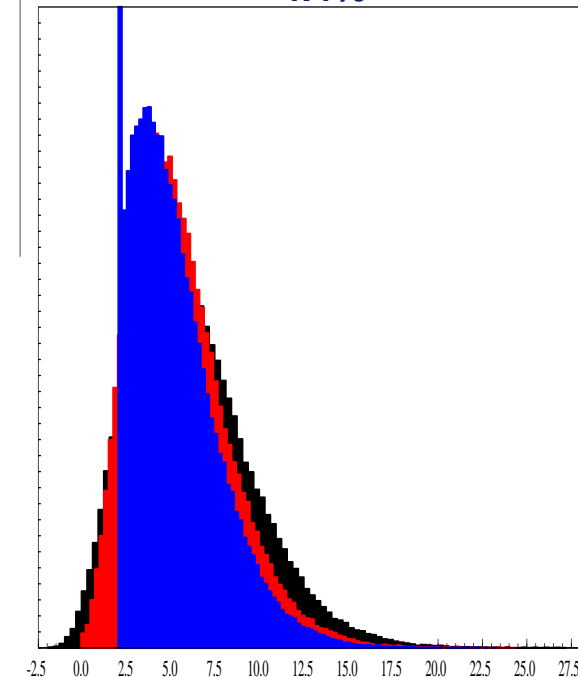
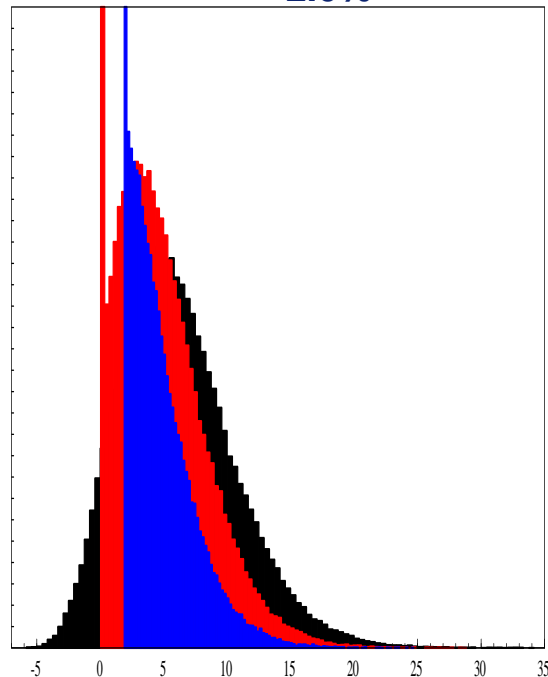
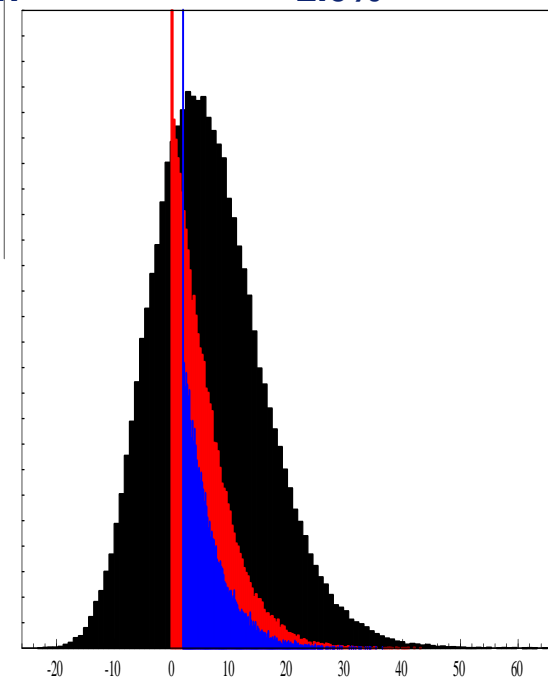
5.0%

2% guar.

2.0%

2.0%

4.4%



# Guarantees (2)



- A risk-free society does not exist
- Reduction in risk results in a reduction of returns:
  - Short horizons → very expensive, low returns, low pensions
  - Long horizons → reduction of risk is limited, so lower costs, higher returns, higher pensions

## Barroso II – political guidelines



- Ageing is a major future challenge...
- The crisis has shown the importance of the European approach to pension systems. It has demonstrated:
  - the interdependence of the various pension pillars within each Member State
  - the importance of common EU approaches on solvency and social adequacy.
  - It also has underlined that pension funds are an important part of the financial system.

# Expected EU level actions



- **Possible EC Green Paper on “pensions” (2010)**
  - Holistic approach on pension systems
- **Revision of the IORP Directive (proposal in 2011-2012)**
  - To fit IORP Directive into new supervisory environment
  - To increase relevance of IORP Directive in all MS
  - To offer pension institutions all benefits of the internal market (e.g. free movement of capital)
  - To facilitate cross-border pension provision for corporates

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