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**Buck Consultants Limited's
response to EU solvency
consultation**

November 2008

Buck Consultants' answers to the consultation questions

A. IORPS subject to Article 17 of the IORP Directive

We have no experience of such schemes and have no comment to make.

B. IORPs operating on a cross-border basis

This section focuses on IORPs that engage in cross-border business. These IORPs could be IORPs covered by Article 17 of the IORP Directive, as well as other IORPs. **The main question here is to what extent the differences in the solvency regimes for IORPs that operate on a cross-border basis are creating internal market problems.** This main question is dealt with by looking first at the rules relating to technical provisions and then at the solvency rules for IORPs operating on a cross-border basis.

(i) Technical provisions

6. The CEIOPS survey shows that, in practice, Member States use different methods and assumptions to determine their technical provisions, partly reflecting historical and cultural differences. Current practices vary from applying best estimates to including extra safety margins in the underlying assumptions and incorporating prudence in different components of the technical provisions. Discount rates applied to the valuation of the technical provisions, for example, vary considerably. Moreover, the treatment of mortality tables is rather diverse, as mortality rates, elements of prudence or incorporation of a trend component to reflect improvements in life expectancy are differently applied. This diversity can result in significant variations in the size of technical provisions across countries for comparable defined benefit commitments, and hence to differences in the level of liabilities to be funded.

Question a) To what extent do you consider greater harmonisation within the EU in this field or in individual elements of the valuation of technical provisions possible or necessary for IORPs operating on a cross-border basis?

We do not believe that there are strong arguments in favour of harmonisation and indeed consider that to move in that direction could prove counterproductive by adding an additional layer of complexity for schemes seeking cross-border status.

Question b) Should prudential requirements be considered separately from Social and Labour Law (SLL)? If yes, how could prudential requirements and SLL be distinguished?

We understood that prudential supervision was concerned with the security of benefits being promised under a scheme, having regard to the standards of governance of the scheme managers and the setting of funding and solvency levels. The minimum level of benefits that had to be promised was governed by Social and Labour Law. This would seem to be a worthwhile distinction to maintain.

7. The CEIOPS survey shows that, in practice, Member States differ markedly in their approaches to inflation protection of the benefits promised. In some Member States they are

conditional, in which case inflation risk is left with the beneficiaries, while in others they are unconditional.

Question a) How should differences in indexation promises (i.e. in nominal, conditionally indexed and real terms) be taken into account or included in a solvency framework for IORPs operating on a cross-border basis?

Solvency rules should be concerned only with the obligatory level of benefits that must be provided.

Question b) Do you foresee any difficulties arising from differences in the specific nature of pension promises in case of cross-border activity?

The requirement that a cross-border scheme is required to relate the guaranteed level of benefits to the social and labour requirements of the host state inevitably creates an administrative complication that could justify not pursuing a cross-border scheme option.

(ii) Solvency rules

8. The IORP Directive has created opportunities for the provision of cross-border pension services, as a first step towards an internal market for occupational pensions. Take-up so far has been rather slow, as full implementation of the Directive was achieved only in 2007. More time is therefore needed for the full effects of the Directive to unfold.

Question a) To what extent are the differences in solvency rules for IORPs operating on a cross-border basis acting as an obstacle towards cross-border activity of occupational pensions?

This is undoubtedly a significant factor. In the UK context, it is, for instance, usually not viable for a scheme to meet the much more onerous funding requirements for cross-border operation simply to facilitate the continued participation of a relatively few individuals working elsewhere in the EU. Without doubt this has had the negative effect of some mobile workers being deprived of the continued provision of defined benefit retirement pensions.

Question b) Do you think that there may be other, and potentially more important, reasons beyond the scope of prudential regulation that complicate the conduct of cross-border activity? Please specify.

The social and labour law requirements referred to above are one such issue. Another is the continued disparity in tax treatment amongst some member states.

9. The IORP Directive lays down only minimum solvency requirements for IORPs. The CEIOPS survey suggests that material variations in regulatory requirements may spur regulatory arbitrage by IORPs operating on a cross-border basis and supervisory competition between Member States.

Question a) Is there any evidence of i) regulatory arbitrage by IORPs operating on a cross-border basis, and/or ii) supervisory competition between Member States? If so, please give examples.

No experience.

Question b) Do you expect regulatory arbitrage by IORPs operating on a cross-border basis, and/or supervisory competition between Member States to occur in the future, and what evidence do you have to support your belief?

No comment.

Question c) Do you think that regulatory arbitrage and/or supervisory competition due to differences in the treatment of IORPs operating on a cross-border basis could ultimately be in the interest of pension beneficiaries or sponsoring undertakings or do you think that this may ultimately be harmful? If so, in what way?

No comment.

Question d) Do you think that the EU solvency rules for IORPs operating on a cross-border basis should be risk-oriented, and based on a market-consistent valuation of assets and liabilities?

No comment.

Question e) Do you think that the definition of the right level and method of risk orientation should be determined at EU level or left to individual Member States?

No comment.

Question f) Do you think that the solvency requirements should include rules relating to governance and disclosure?

Possibly.

10. The CEIOPS survey shows that the existing solvency regimes for IORPs operating on the cross-border basis are very diverse. This is reflected in different valuation methods for technical provisions and in the variety of security mechanisms. But, this does not necessarily imply substantially different security levels provided to beneficiaries between Member States. In practice, the different security mechanisms are linked to one another and may operate simultaneously. By implication, as different approaches can be used to secure pension benefits, national pension supervision frameworks do not necessarily have to be identical. In practice, there may be several degrees of harmonisation, or harmonisation only of some elements.

Question a) Do you think that a harmonised solvency regime for IORPs operating on a cross-border basis is desirable? Please outline in broad terms how such a regime would look like.

As for question 6a, we do not believe that there are strong arguments in favour of harmonisation and indeed consider that to move in that direction could prove

counterproductive by adding an additional disincentive for schemes seeking cross-border status.

Question b) Do you think that in some parts or elements of the solvency regime there is scope for harmonisation? If so, for which parts or elements?

No further comment.

Question c) Is there scope to consider separately different types of IORPs operating on a cross-border basis in this harmonisation? Please explain that view.

Yes. We would suggest that there are at least three distinct circumstances in which a scheme may become subject to the IORPS cross-border requirements and, whether or not there is a move towards greater harmonisation, it would be desirable to treat each in a different way. From a UK perspective, the three categories are:

- 1. Scheme established by UK-based employer for employees based primarily in the UK. One or more employees are sent to work for associated company based elsewhere in the EU for an extended period.**
- 2. Scheme initially established by UK-based employer for employees based primarily in the UK. Other companies within the same group have small operations elsewhere in the EU and there could be efficiencies in using the UK scheme for pension provision.**
- 3. Commercial organisation establishing an EU-wide scheme to which employers in many countries could contribute to provide employees with pensions.**

We are aware of a number of examples within the first group where the impact of the IORP directive and the potential need for full funding has resulted in expatriate employees being deprived of ongoing defined benefit pension provision in order avoid the requirement.

Question d) Do you see any problems relating to a harmonised approach?

No further comment.

Question e) Do you think that the current solvency regimes for IORPs operating on a cross-border basis, which are based on minimum harmonisation, provide a more desirable outcome? Please explain that view.

In general we are reluctant to see additional complications put in the way of pension provision.

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