

AAE POSITION ON IORP II DIRECTIVE

BY **TATIANA BITUNSKA** AND **PHILIP SHIER**



TATIANA BITUNSKA

is Chair of the Pension
Committee.

AAE is a professional association of actuaries who are well known as financial architects of society because their combination of analytical and business skills is used to address a growing variety of financial and social challenges worldwide. Actuaries are expected to provide decision-makers with valuable information to assist them to take long-term strategic decisions, as well as providing practical solutions to problems involving the possible consequences of future uncertain events.

There are many challenges to be addressed: demographic risks related to ageing population, changing balance between working population and retired people, how to prevent (mitigate) the poverty risk or to assess intergenerational fairness, how to support wellbeing of societies in the low real interest rate environment, and last but not least – how to deal with the issues of sustainability and climate change to protect our future. All mentioned above requires active and conscious attitude from all of us. >

PHILIP SHIER
is Chair of the
TF review IORP2.

AAE believes that actuaries can play a key role at both national and European level in solving different type of problems related to the provision of adequate and secure pensions.

The AAE Pension Committee established a special taskforce to develop a submission to the EIOPA consultation process related to ongoing review of the IORP II Directive. The key issues on which the AAE commented included:

- 1. Movement of DB to DC plans is a big challenge as risk is transferred to individual members.** Regulation needs to ensure balance between the interests of the different stakeholders, recognizing that members ultimately bear the risk. We support the proposal that members should be provided with long term risk assessments, which actuaries are ideally placed to provide.
- 2. Effective risk management in IORPs is essential to protect the interests of all members and beneficiaries, as well as the IORP itself.** Our position is that the actuaries with their expertise are able to provide valuable input in different areas including the own risk assessment, benefits projections provided in the Pensions Benefit Statement, asset liability matching (including liability driven investment strategies) as well as the responsibilities of the actuarial function for defined benefit plans as set out in Article 48. That is why we consider also the role of actuaries in risk management for IORPs.



3. Governance and Prudential requirements.

AAE believes that proportionality should be taken into account in regulation and supervision. However, our view is that the criteria should be more risk based rather than based on the size of the IORP and that risk should be considered from both the IORP perspective and the beneficiary perspective. We are aware that the national legislation varies a lot and therefore the landscape of IORPs in different countries as well. A set of 'risk assessment guidelines' with formula/methods for how the different risks can be assessed (developed by EIOPA) would be considered as useful, with a requirement on the IORP to comply with the guidelines or explain why if it has not done so. The actuary could provide assistance with this aspect. Risk tolerance level (defined by the management) should be included in the ORA process. >

4. Information provided to members and cost disclosure. AAE believes that members of IORPs should be provided with clear and value-adding information on the benefits they may expect to receive on retirement, and on the costs and charges incurred. Cost transparency and reliable information provided to the members can help them to manage in more efficient way their future pension benefits.

AAE highlighted three particular issues in our submission:

- Members should not be provided with too much information; the key information which will help the member to understand the benefits they may receive, the level of risk being taken (where members bear investment risk) and the charges incurred should be highlighted with more detail and other information (e.g. on sustainability) made available. A digital approach, with layered information available by clicking on links, would facilitate this approach, although provision will also need to be made for members who require paper copies of the PBS;
- Projections based on a ‘favourable’ scenario should be shown on the PBS in addition to the current ‘best estimate’ and ‘unfavourable’ ones to provide members with a balanced understanding of the potential risks and rewards;
- Care should be taken to ensure that information on costs and charges provides sufficient detail on the breadth and quality of services provided so that the member can make an informed decision on value-for-money.

Protection of purchasing power of pensions benefits is another point. AAE recognizes as an important issue the lack of mechanism for protecting pensions against inflation.

5. The importance of the Own Risk Assessment (ORA). It is important to note that this is a minimum harmonisation Directive and that national legislation determines the solvency requirements for IORPs within the very high-level provisions in the Directive. Accordingly the ORA does not directly address solvency (as in the ORSA under Solvency II) but the findings of the ORA will enable Boards and supervisors to ensure that the IORP has adequate funding to provide the benefits promised to members. For different pension schemes biometric or investment risks can be shared between the IORPs, sponsors and members of IORPs in different ways. In some cases these risks could be shifted by the IORPs to other ultimate risk takers. It is important that the ORA considers the impact on members and beneficiaries where members bear risks. Shifting the biometrical and investment risks to other stakeholders has significant implications on investment behaviour and investment choices made by IORPs. The analysis of such investment choices may include the impact on the real economy but the primary objective should be to provide adequate and secure income for people after retiring. <