

AAE  
POSITION  
PAPER



# AAE POSITION PAPER ON THE REVIEW OF THE IORP II DIRECTIVE

DECEMBER 2024



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ACTUARIAL  
ASSOCIATION  
OF EUROPE

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This position paper by the Actuarial Association of Europe (AAE) examines the review of the IORP II Directive, commenting on the technical advice provided by EIOPA in September 2023, focusing on governance, risk management, sustainability, and the evolving landscape of occupational pensions in Europe. The paper provides our insights in relation to IORP II, aiming to support the ongoing discussions for the review of the Directive.

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This paper is a position paper of the Actuarial Association of Europe. Any views expressed in this paper are views to stimulate and inform further discussion and should not be read as being representative either of the authors' or contributors' individual opinions or of their employers or professional organisations.

## EXECUTIVE SUMMARY

The Actuarial Association of Europe (AAE) appreciates the opportunity to provide its perspective on the review of the IORP II Directive. This paper outlines the views of the AAE on how the Directive can be further developed to promote enhanced governance, effective risk management, and sustainability within European occupational pensions.

Actuaries are central to the robust governance of pension schemes, applying their expertise in areas such as risk management, actuarial valuations, and investment advice. Given the increasing complexity and evolving landscape of European pensions, the AAE sees value in the proposed reforms and suggests a balanced approach that prepares for the future and at the same time respects both consistency and national specificity.

*We would like to emphasise that the Executive Summary provides an abbreviated version of the contents of this paper which does not constitute the entirety of the AAE's views and opinions. Moreover, we would like to caveat that there are further details and recommendations set out in the body of this paper which are essential and comprise an integral part of the AAE's views with respect to the review of the IORP II Directive. As such, the reader should not rely solely on the Executive Summary. A comprehensive read of our paper is essential for the full understanding of the AAE's views and opinions.*

- **Governance and Prudential Standards:** The AAE acknowledges that the IORP Directive's minimum harmonisation framework allows Member States (MS) flexibility to adapt regulations to their national pension landscapes, which vary significantly across the EU. While supporting this approach, the AAE advocates for guidelines and sharing of knowledge that promote good and consistent practices across MS, balancing the need for alignment with the respect for national specificities.

In line with EIOPA's advice on proportionality, the AAE believes that governance and prudential standards should be proportionate to the risk profile of each IORP. The AAE would agree with increasing the membership and asset threshold for exemptions, provided that the grandfathering clause is revisited to ensure legacy schemes can transition to adequate supervision. The AAE supports standardised risk assessments (SRAs) as a way to deepen understanding of risks across MS, provided they are used for insight, transparency and knowledge sharing.

- **Cross-Border Activities and Transfers:** The AAE supports EIOPA's recommendation for a prudential assessment during the registration or authorisation of IORPs, seeing it as beneficial for member security and potentially reducing barriers to cross-border operations. Additionally, the AAE agrees with EIOPA's approach for clarity in cross-border transfer approvals and endorses enhanced supervisory cooperation across Member States, as this fosters knowledge-sharing, reduces regulatory inconsistencies, and promotes good practices in risk management.

- **Information to Members and Beneficiaries:** The AAE is supportive of the efforts to improve member engagement and understanding, particularly regarding cost transparency and projected benefits. Clear and meaningful information, based on appropriate assumptions regarding benefit projections, can empower members to make informed decisions about their pension benefits. The AAE views the layering of information as an effective approach, enabling members to access additional insights as desired, with digital formats as a suitable default option. Greater transparency on costs and charges, and the projected impact on retirement income helps members better understand the value provided by their IORP and assess whether the costs incurred are proportionate to the services and value added.
- **Shift from Defined Benefit (DB) to Defined Contribution (DC) Schemes:** The AAE underscores the importance of clear definitions within both DB and DC schemes to aid regulatory frameworks, addressing distinctions such as lump sum vs. annuity, the provision of guarantees and other factors which distinguish the different types of DB and DC schemes. This level of specificity is essential for a precise regulatory and supervisory approach. To manage long-term risks associated with DC schemes, the AAE highlights the value of performing risk assessments that consider members' retirement income projections and investment risk tolerance. The AAE supports practical, cost-effective approaches to achieving these assessments, balancing the need for comprehensive insights with the financial implications for IORPs.
- **Sustainability and Fiduciary Duties:** The AAE supports the integration of sustainability considerations into financial and investment decision-making across Europe, viewing it as a beneficial addition to the IORP II Directive. A proportionate approach to sustainability requirements can align with the Directive's prudent person rule, ensuring that members' long-term financial interests remain central. The AAE sees stewardship as a valuable component of responsible investment, particularly for larger IORPs, with practical guidance enabling smaller schemes to meet these standards effectively.
- **Diversity and Inclusion in Governance Structures:** The AAE acknowledges diversity and inclusion as integral to IORP governance, contributing to enhanced decision-making and reflecting broader societal goals. In line with EIOPA's recommendations, the AAE sees value in the development and disclosure of diversity policies and targets that address the governance needs of each IORP and provide for good representation of its membership and demographics, with due consideration of fit and proper requirements.

The AAE remains committed to contributing actuarial expertise to this dialogue and supporting the long-term resilience of European pension systems.

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## INTRODUCTION

Following the publication of EIOPA's technical advice for the review of the IORP II Directive in September 2023, and in preparation for the upcoming proposal for its review by the European Commission, the Actuarial Association of Europe ('AAE') has prepared this position paper for the purposes of setting out our views on the review of IORP II.

*This paper is intended for readers that have good knowledge of EIOPA's technical advice and the IORP II Directive and its review process.*

The European Commission, EIOPA, and other stakeholders are welcome to contact the AAE for further input and clarifications.

The AAE represents 38 national actuarial associations in 37 European countries. Our member associations represent circa 30,000 actuaries, with many of those working with pension schemes across Europe, or other businesses or institutions within the pensions landscape.

Pensions actuaries carry out work for pension funds in relation to funding actuarial valuations that determine the financial health of pension funds or may be involved in the design of pensions benefit structures as well as advice for setting a pension fund's investment strategy and risk management system, among other areas. In this context, the AAE supports European institutions by providing the technical and practical expertise of its members and plays a prominent role in shaping the development of new, and the review and refinement of existing, European legislation.

The AAE emphasises the vital role actuaries play in ensuring good governance of IORPs, given their expertise in assessing and managing risks, designing benefit structures, and advising on investment strategies. Actuaries are instrumental in maintaining the integrity and sustainability of pension schemes.

This document shares our views on the planned review of the IORP II Directive with respect to the following topics:

1. General comments
2. Governance and prudential standards
3. Cross Border activities and transfers
4. Information to members and beneficiaries and other business conduct requirements
5. Shift from DB to DC
6. Sustainability
7. Diversity and inclusion

## 1. GENERAL COMMENTS

### A. 'PROTECTING THE LEGACY' AND/OR 'EMBRACING THE FUTURE'

In its advice, EIOPA discusses a balance between 'protecting the legacy' and 'embracing the future'. From an actuarial point of view, we believe the future is more important than the past<sup>1</sup> and in general believe that regulation should be drafted in a way that protects members and beneficiaries in the best way possible. Too much focus on protecting the legacy entails the risk of insufficient risk management and governance, and inconsistent standards for the valuation of assets and liabilities.

#### SUMMARY | 'PROTECTING THE LEGACY' AND/OR 'EMBRACING THE FUTURE'

The AAE advocates for appropriate principles-based risk management, valuation techniques, and supervision which are proportionate to the risk profile of IORPs, including members, beneficiaries and their sponsors. Protecting legacy just for the sake of transitional costs and difficulties should be approached with caution. However, appreciating the evident implementation challenges, we can support transitional phases where necessary to ease the implementation burden of new rules in a secure and proportionate way, with a direction towards a gradual 'embracing of the future'.

### B. HARMONISATION

The IORP Directive is presently a minimum harmonisation Directive. In its advice, EIOPA *'recognises the heterogeneity of pension systems across the EU and the variety of IORPs within national pensions sectors. Therefore, EIOPA's advice aims to strike a proper balance between further convergence to meet future challenges and preserving the minimum harmonisation character of the IORP Directive.'*<sup>2</sup>

The term 'minimum harmonisation' implies that MS should be given flexibility to adopt their own approach to regulation and might be interpreted as a 'lowest common denominator' approach. The AAE recognises and supports the need for MS flexibility in certain aspects to enable appropriate regulation, having regard to national specificities. In addition, the AAE strongly recommends the development of good practices through the publication of guidelines, which can be adopted by MS to enhance the security of members and beneficiaries.

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 1 With 'the past' we mean past compliance and legislation and not past pension plans, arrangements or member/beneficiary rights. These of course need to be honoured and protected through modern risk management.

2 Para 1.4.3

The AAE views harmonisation as a tool to achieve specific goals—improving outcomes for members and beneficiaries, and enhancing governance and risk management across European IORPs—rather than as an objective in itself. As such, the target level of harmonisation should be assessed relative to the likelihood of achieving this goal and taking into account the specificities of national IORP systems. In the end, all EU citizens and IORP sponsors should be entitled to the same level of protection and appropriate risk management.

#### SUMMARY | HARMONISATION

The AAE recognises that the context in which IORPs operate varies between MS due to national specificities such as tax and labour law, social security systems, and significant differences in the history of IORPs in some countries. However, the fundamental concept of pensions, which is to save and invest money to provide an income in retirement, is universal for all IORPs. As such, regulation and supervision should be based on the *common core principles* of sound risk management, actuarial methods for valuation and adequate funding requirements, robust governance, and member/beneficiary protection, but taking into consideration and respecting national specificities.



## 2. GOVERNANCE AND PRUDENTIAL STANDARDS

### A. PROPORTIONALITY

In their advice, EIOPA have provided the following advice:<sup>3</sup>

*‘EIOPA considers it essential that supervision is risk-based and forward-looking and that the governance and prudential standards in the IORP II Directive are applied in a manner that is proportionate to the risk profile of IORPs.’*

AAE is fully supportive of this approach, but we emphasise that the risk profile needs to be considered from IORP, sponsor and member/beneficiary perspective.

The fundamental question is whether the application of proportionality is determined centrally i.e., enshrined in the Directive, or nationally through the National Competent Authority (‘NCA’). One aspect of the issue is the exemption under Article 5 which states that ‘... Member States may choose not to apply this Directive, in whole or in part, to any IORP registered or authorised in their territories which operates pension schemes which together have less than 100 members in total.’

We note that in practice:

- A number of MS have chosen not to apply this exemption i.e., all IORPs in that MS are subject to the full requirements of the Directive.
- Where the exemption is applied, it is usually applied ‘in whole’ i.e., in that MS, application of the Directive is ‘all or nothing’ for IORPs with less than 100 members.

EIOPA has decided to advise that the threshold is increased from 100 members (i.e. *without* consideration of how many beneficiaries there are in the IORP) to 1,000 members and beneficiaries and €25 million in assets (with the higher level of €50m applying for the purposes of horizontal legislation like DORA and CSDR), with grandfathering for those small schemes currently exempt who would not be exempt under the new requirements.<sup>4</sup>

From the perspective of protecting members and beneficiaries, there is no good reason for a grandfathering clause as it will allow for certain high-risk IORPs to be exempted from implementing good risk management and governance. The AAE does not believe it is a valid argument, that just because an IORP used to be excluded it should also be excluded ‘tomorrow’ – the world is getting better and better at risk management and protecting benefit promises and this should benefit all members and beneficiaries.

.....  
3 Section 2.3.6. blue box

4 This would apply where an IORP has less than 100 members but more than €25million in assets. In practice, this is most likely to arise where an IORP has few ‘pre-retirement’ members but a lot of beneficiaries i.e. ‘post-retirement’.

**SUMMARY | PROPORTIONALITY | THRESHOLDS**

The AAE believes that all members and beneficiaries should benefit from the same level of protection. We therefore reiterate our position from our submission to the EIOPA consultation in 2023 that proportionality measures should be risk-based from both an IORP *and* member/beneficiary perspective, rather than based on an arbitrary quantitative threshold as a proxy for risk. However, we acknowledge that this would be difficult to implement in the Directive due to the inherent subjectivity in such classifications, as per EIOPA's conclusions.

The AAE would be supportive of the proposed change of the threshold to '1,000 members *and* beneficiaries and less than €25 million in assets' provided that it would be accompanied by a phasing out of the proposed grandfathering clause with appropriate transitional arrangements. In conclusion, the AAE can support the introduction of *objective thresholds and limits* that provide for risk-based supervision.

EIOPA emphasises that MS have the ability to decide, for IORPs under the proposed new threshold, to apply the *parts* of the Directive which they consider necessary and proportionate for adequate supervision. This is in effect applying the 'minimum harmonisation' principle by delegating to MS the responsibility for deciding what level of regulation and supervision should apply to IORPs under this new threshold. We would encourage a 'comply or explain' approach for such IORPs as we proposed in our submission to the EIOPA consultation in 2023.

Under the proposed increased exemption limits, around 30% of IORPs<sup>5</sup> would potentially be exempt and it will be up to the MS to decide how to implement exemptions in national rules. The AAE could understand the proposed approach provided that MS exercise their option in a proportionate and risk-based way, rather than the 'all or nothing' approach which has generally applied for IORPs under the 100-member threshold. It is noted that under the proposed exemption limits, there is a significant percentage of IORPs that could be exempted, and would emphasise that smaller IORPs which are exposed to high risks should be supervised in a way which is proportionate to those risks rather than exempting them altogether.

**SUMMARY | PROPORTIONALITY | HARMONISATION**

The AAE believes that IORPs below the 'small schemes' threshold (if this is applied by the MS) should have appropriate and proportionate regulation and supervision. To this extent, we recommend the development of guidelines, in consultation with NCAs, regarding the proportionate application of the requirements for small schemes, in order to address the issue of an 'all or nothing approach' which has been the practice of most NCAs. We highlight the relevance of professional judgement in tailoring proportionality measures to the specific risk profiles of IORPs, ensuring fair and effective governance.

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5 Source: Section 2.3.5 in EIOPA Technical Advice (EIOPA-BoS-23/341)

## B. LIQUIDITY RISK MANAGEMENT

In general, the AAE is supportive of improving guidance on risk management in high-risk areas. There is always a risk of tunnel vision when addressing specific risks more than ‘those not mentioned’, but due to the potential macroeconomic consequences of liquidity risk (like recently seen in the UK and the Netherlands) the AAE is supportive of the increased additional focus on this area. In this regard, the Directive could articulate more explicitly the objectives that should be achieved in the management of liquidity risk.

While the focus on liquidity risk is necessary, it is crucial to adopt a comprehensive risk management approach that anticipates rather than reacts to events. Effective risk management must account for all potential risks with proactive and justified measures.

### SUMMARY | LIQUIDITY RISK MANAGEMENT

The AAE support EIOPA’s advice of issuing guidelines or opinions to NCAs on liquidity risk. We also welcome EIOPA’s consultation on the supervision of liquidity risk management, issued in Q4 2024.

## C. OPERATION OF IORPS AND MANAGEMENT OF CONFLICT OF INTEREST WITH SERVICE PROVIDERS

EIOPA advises including explicit requirements on business models and operations, including managing conflicts of interest with service providers. The AAE is supportive of this and acknowledges the risk of detrimental effects on the protection of member and beneficiaries if conflicts are not managed adequately. Conflicts of interest are mentioned in the ORA already, but we believe guidance and focus can be increased to mitigate the business, operational, and governance risks, particularly in relation to multi-sponsor IORP providers (MIPs) which are associated with service providers. The guidelines should ideally set out the goals to be achieved from the management of such conflicts of interest and should ensure that they do not contradict any regulations or guidelines obeyed by service providers.

### SUMMARY | OPERATION OF IORPS AND MANAGEMENT OF CONFLICT OF INTEREST WITH SERVICE PROVIDERS

The AAE supports the EIOPA advice of issuing guidelines or opinion to NCAs.

## D. EFFECTIVE USE OF DATA

EIOPA advises to empower NCAs to collect regular quantitative data but to refrain from adding minimum reporting requirements for the time being. Reporting is often seen as a pure cost from a business perspective and the AAE acknowledges that NCAs must be wary not to ask for reporting ‘for the sake of reporting’. It would be reasonable for reports and information to be requested by NCAs provided that this does not create obstacles in cross-border business for the IORP itself or for its service providers. The AAE is supportive of reporting in the interest of better macroeconomic understanding of both national and European risks. An important initiative in this context is the pensions dashboard, regularly published by EIOPA.

The AAE further emphasises the importance of sharing knowledge between NCAs and MS on reporting and use of data to get the best quality and most effective data to the benefit of NCAs, IORPs, and members and beneficiaries. If this means centralising reporting requirements through reporting templates or other means issued by EIOPA, the AAE will be supportive of this and can assist in defining the relevant reporting requirements.

### SUMMARY | EFFECTIVE USE OF DATA

The AAE supports EIOPA’s recommendation to clarify Article 50 for the purposes of *regular quantitative reporting* to NCAs and emphasises the importance of sharing knowledge between NCAs and MS on reporting and effective use of quality data. If quality and frequency vary too much between MS and NCAs, a centralised approach through EIOPA could be a better way forward.

## E. STANDARDISED RISK ASSESSMENTS

The AAE welcomes the focus of EIOPA’s advice on risk management and reiterates its view that guidelines should be developed as good practice emerges in relation to issues such as the Own Risk Assessment (‘ORA’).

We would emphasise that for DC IORPs, the majority of risks are typically borne by the members and in considering the application of the Directive for DC IORPs, the potential risk to the members must be given priority. More generally, we would expect that the requirements of Standardised Risk Assessments would vary between DB and DC plans, recognising the different nature of their operations.

The AAE believes that the principles of sound risk management and the calculation methods for risk assessments are relevant to all types of IORPs and all MS, notwithstanding the perceived heterogeneity of IORPs across Europe. It would be in the interests of members and beneficiaries of IORPs, and the IORPs and sponsors themselves, to adopt best practices in risk management. This can be supported through the development of a set of ‘risk assessment guidelines’ to support reporting that would lead to better insights and understanding of the risks in both

MS and on a European level. The AAE would be well positioned to provide input for the development of these guidelines.

It is noted that the current rules governing funding valuations provide for a prudent approach to pension scheme funding, including guidance on setting assumptions in a prudent manner. These requirements should be respected and be seen as adequate, provided that they are fulfilled by IORPs. Supervisory intervention at a local level, for the objective of ensuring member and beneficiary protection, can be adequately assessed based on current funding rules.

The heterogeneity across EU countries and variations in valuation standards does not accommodate a comparable and transparent basis that can be used to draw conclusions about the risks and vulnerabilities of IORPs. In this regard, pan-European stress tests which are already carried out, and SRAs, can provide useful information to EIOPA and allow for a better understanding of risks and vulnerabilities to which IORPs are exposed. SRAs can be useful to the extent that the analysed risks, the underlying pension systems/arrangements, and the affected risk takers are standardised to support comparability. Moreover, SRA requirements should reflect the sponsor covenant and assess the potential impact on benefit promises in situations where there is a deterioration in the sponsor's ability or willingness to support the scheme

The introduction of explicit SRA requirements should consider the risks, such as increasing compliance costs to pension schemes, and balance this against the benefits that SRAs could provide. Although comparability and transparency in reporting could prove useful to supervisors, this should not come at the cost of deterring pensions scheme sponsors from continuing to operate the schemes. Allowing supervisory intervention based on the outcome of SRAs could be a significant change in direction versus the already adopted funding requirements in member states, especially considering the potential for additional funding volatility that could be introduced through a set of universal rules that do not adequately represent scheme-specific (or market-specific) characteristics. Within the EIOPA advice, there is an element of ambiguity with respect to NCA supervisory intervention driven by the outcome of SRAs, which should be further developed and clarified.

#### SUMMARY | STANDARDISED RISK ASSESSMENTS

The AAE recognises the usefulness of SRAs to EIOPA in enhancing the understanding of risks and vulnerabilities based on a comparable basis. However, the introduction of such a requirement should respect *national funding requirements*. Complementary to SRAs could be the development of a set of 'risk assessment guidelines' outlining the suggested methods for how different risks can be assessed. This is already served (in-part) through EIOPA stress tests that are carried out on a common balance sheet approach.

## F. ORA POLICY

The EIOPA advice describes different arguments and options for introducing an ORA policy and advises to introduce an ORA policy by supplementing the requirements with principles for an ORA policy and the consideration of the IORP's risk tolerance limits.

The AAE strongly supports the view that the identification of material risks and the derivation of risk tolerance limits are important issues that the governance and risk management systems of IORPs should address.

In particular, the ORA should report on the management of these risks and any deviations from the agreed risk tolerance limits. The explicit articulation of risk tolerance limits and risk appetite should be a general and necessary requirement for on-going sound risk management and governance and should not be solely regarded as an isolated part of the ORA process which is typically carried out once every three years. The focus should therefore be on introducing governance requirements for a dynamic and on-going risk management framework for IORPs, to enable the effective management of risks to which IORPs are exposed. We note that certain risks such as sponsor risk and inflation risk could be addressed more explicitly within the requirements of the Directive.

As noted in our submission to the EIOPA consultation in 2023, we do not consider it necessary or indeed appropriate at this stage to specify the elements of the ORA policy in the Directive.

There is a requirement for the ORA to be undertaken and IORPs should develop their own policies appropriate to their specific situation. If a supervisor does not consider that the ORA and/or the process by which it has been undertaken is appropriate, this can be challenged accordingly, and good practice would be expected to emerge over time.

It is recognised that good practices in risk management, include documentation of how risk assessments are carried out and, as such, it would be beneficial to document IORPs' approach to how they carry out their ORA. Although a stand-alone document for the ORA policy could be considered, a more integrated approach would be preferable, where the existing Risk Management Policy of the IORP sets out the principles, processes and procedures based on which the ORA is conducted.

We emphasise the importance to consider risk management as a regular and on-going activity within pension schemes, and not as a tick box exercise that is carried out for the purposes of compliance. As such, it should add long-term value and offer better protection and security for the benefit of members and beneficiaries. To avoid this 'tick-boxing' approach, we suggest the implementation of regular training provided by NCAs or EIOPA. In line with the [OECD's Private Pension Governance Guidelines](#), this could include simple and accessible measures such as webinars offered once or twice a year to promote continuous education and awareness.

**SUMMARY | ORA POLICY**

The AAE does not believe it is necessary to specify the elements of the ORA policy in the Directive. We do however believe the intention and purpose behind the ORA policy is very important and support best practices in risk management. In this respect, a principles-based policy for how IORPs conduct their ORA would be beneficial and would support better risk management governance. IORPs can develop their own policies appropriate to their specific circumstances. The policy of how the ORA is carried out should form part of the general risk management system of an IORP and be integrated within its existing Risk Management Policy.

Moreover, we would encourage the requirement of explicitly articulating risk appetite and risk tolerance limits to be included within the Directive. Subsequently, it should be a requirement that the risk appetite and risk tolerance limits are considered and tested within the ORA process.

### **3. CROSS BORDER ACTIVITIES AND TRANSFERS**

#### **A. PRUDENTIAL ASSESSMENT WITHIN PROCESS OF REGISTRATION OR AUTHORISATION**

EIOPA advises that NCAs should be required to perform a prudential assessment as part of the registration or authorisation process of all IORPs, which may eliminate some of the obstacles to cross border activity.

The AAE can see merit in requiring prudential assessment of all new IORPs to enhance member security, and so we are supportive of this proposal in principle.

#### **B. CROSS-BORDER TRANSFERS**

In our submission to the consultation, we noted that ‘It seems desirable that there should be clarity and consistency in relation to the definition and determination of ‘majority’ with respect to the approval of cross-border transfers’, and we consider the approach proposed by EIOPA in this regard to be reasonable.

#### **C. SUPERVISORY CO-OPERATION**

The AAE supports supervisory co-operation and believes this is both beneficial for improved sharing of knowledge between MS and a necessary step towards more success for an internal market for IORPs with enhanced understanding of systemic risks. From our perspective it is important to avoid regulatory arbitrage, and we support the principle of wider supervisory co-operation which would in turn support the further development of best practices.



## 4. INFORMATION TO MEMBERS AND BENEFICIARIES AND OTHER BUSINESS CONDUCT REQUIREMENTS

The AAE is pleased to note that EIOPA's advice reflects the AAE view on a number of issues, such as, but not limited to:

- The need for concise and meaningful information
- Member State-specific templates
- Digitalisation (with protection for vulnerable groups) and layering of information
- Inclusion of a third 'favourable' scenario for the PBS in DC schemes

The AAE is supportive of the development of Pensions Tracking Systems (PTS) to enable individuals to get a complete view of their overall pension expectations (ideally including first pillar entitlements), which would support the initiative to address the pensions gap issue in Europe. However, we note that PTS can vary widely between MS in terms of development stage and it is important that each IORP continues to be responsible for providing members with clear and useful information, which can be collated in the PTS when it becomes possible.

### A. PENSION BENEFIT STATEMENT

The AAE welcomes EIOPA's proposal to amend Article 38 to require that *'The document shall provide information on the level of risk borne by the member'*. It is of course essential that the information provided is meaningful to the member and we believe that actuaries are well placed to assist with this. We note that, if we really want to make the PBS a success then it should provide an option for 'call for action', for example to direct the reader to go to a website for more information or to encourage the member to make adjustments e.g., to their contribution rate or investment choices.

We consider layering of information to be essential, and suggest that much of the information which might be included in the PBS should be made available by links to other sources. This could include information on sustainability, past performance, investment options and costs (where applicable and members bear the investment risk).

EIOPA has made a number of proposals which relate only to IORPs where members bear investment risks and may have investment choice. In particular, EIOPA advises that information is provided on the return on investments at least over the past 12 months and, where members are offered investment choice, information on the member's preferred choice, including an indication of the risk level.

**SUMMARY | PBS**

The AAE supports the provision of this information, provided it does not make the PBS cluttered and harder to read, which could deter members from engaging with the information provided, e.g. some of this information could be provided separately using a layered approach at appropriate time intervals. The AAE notes that EIOPA recommends *‘that the PBS should be designed with a behavioural purpose’* which is appropriate for IORPs where members can make investment and contribution rate choices. In connection to this, we would suggest that the information on past performance carries the appropriate caveats that past performance is not a guide to the future. Where appropriate, *average* annualised returns can be shown over a long-enough period, while also indicating the volatility or drawdown in individual years.

**B. DIGITALISATION**

We note and support EIOPA’s statement<sup>6</sup>

*‘Digital disclosures offer great opportunities for presenting information in an engaging and simple manner. There are multiple advantages, for example, flexibility in the structure, which allows layering, and the application of interactive elements, such as infographics, videos and images. The use of such tools should aim at promoting good outcomes for members and beneficiaries and not seek to take advantage of behavioural biases...’*

EIOPA proposes to amend Article 38(3) to provide that the PBS shall be made available in hard copy or digitally at the member’s preference. We recognise that some vulnerable members will require, or would prefer, paper copies and this must be facilitated by establishing the member preference. EIOPA suggests doing this ‘at least at the beginning of membership’ but it is not clear what would be required in relation to existing members and what should be done if the member does not indicate a preference – the AAE preference is that digital should be the default option.

EIOPA notes the importance of choice architecture (where members have choices) and recommends that a requirement is introduced so that *‘IORPs shall put in place safeguards such as choice guidance to support the member or beneficiary when making choices.’* The AAE recognises the importance of choice architecture and would be pleased to assist in developing this topic.

.....  
6 Blue box 4.3.3

**SUMMARY | DIGITALISATION**

The AAE believes that we should embrace the future by making information available in digital format, whilst protecting those legacy members who express a preference for hard copy statements. The AAE's view is that digital should be the default option where no preference is expressed, due to accessibility and cost considerations.

The AAE recognises that choice architecture is important for members who can make choices and would be pleased to assist in developing this topic.

**C. TRANSPARENCY ON COST AND CHARGES**

The proposal is to 'develop the provisions on cost transparency' for IORPs where members bear investment risk or have investment choice. In such IORPs the PBS must show **all costs incurred, directly and indirectly**, by members and beneficiaries over the previous 12 months and an estimate of the impact of costs on the final capital accumulated. The AAE recommends that it is specified in the Directive, or elsewhere, which costs and charges must be disclosed, as with PRIIPs and MiFID II. If this specification is not provided, there could be different levels of disclosure between IORPs and between IORPs and other savings vehicles which is not desirable.

Control of costs is of course important to achieve good investment returns, but members may not always or easily understand this because what is provided in return for costs/charges may be opaque in many cases.

**SUMMARY | TRANSPARENCY ON COST AND CHARGES**

The AAE supports the principle of transparency to members and beneficiaries in relation to costs and charges incurred which impact their retirement outcomes, and recommends that the costs and charges which must be disclosed are clearly specified. However, it is equally important to assess the overall value-for-money offered by taking into consideration other factors such as quality and level of services provided in return, as well as the potential return and type of investments.

## D. PROJECTIONS

We agree that providing members with an estimate of their projected retirement benefits is crucial as it will help them to decide what actions, if any, they should take to aim for their desired level of retirement income. The biggest challenge is presenting the information in an understandable way, bearing in mind the varying levels of financial literacy of members. Regarding the variability of projections year-on-year, it is important to establish principles or rules of thumb that provide consistency while reflecting market conditions to an appropriate degree. The calculation basis should allow for some variability due to market factors but avoid excessive fluctuations that could confuse members or mislead expectations.

We welcome EIOPA's advice that, where the retirement benefits depend on future investment returns, members should receive projections based on a 'best estimate' scenario, an 'unfavourable scenario', and a 'favourable scenario', to demonstrate the uncertainty of future outcomes. In our consultation response, we expressed concern that many members may not understand that the term 'best estimate' means the central scenario; EIOPA has responded to this by stating:

*'While the EIOPA model benefit statement designs use the terminology 'best estimation scenario', EIOPA does not consider that the Directive requires terminology relating to 'best estimate' to be used.'*

Consistency in the information provided to members and beneficiaries is key to supporting the understanding of the recipients of information. Although this may not be in the scope of the IORP II Directive, it is useful to consider the consistency of information that members may receive from other sources or non-IORP pensions providers such as insurance companies and 1<sup>st</sup> pillar pension systems.

The AAE agrees that outcomes should be illustrated in real terms so that members can assess the real purchasing power of their projected income at retirement. This is particularly important due to the relationship between investment returns, price and salary inflation over a long period of time.

A proposed amendment to Article 40(1)(c) would require information to be given about the assumptions used in the projections, which we support. The responsibility for the rules for determining the assumptions falls on the MS under the existing Article 38(5) and no amendment is proposed.

### SUMMARY | PROJECTIONS

The AAE supports EIOPA's proposal and suggests that MS make use of suitable experts (including actuaries) to ensure that members are provided with reasonable and consistent projections based on appropriate and consistent assumptions.

## E. OTHER BUSINESS CONDUCT REQUIREMENTS

EIOPA introduces this section with a good analysis of the issue:

*‘MiFID, IDD and PEPP contain POG requirements to ensure that investment products, including personal pension products, are designed such that they are appropriate for, and serve the needs of, an identified target market. Some of the principles of POG such as regarding a product approval process or the intended distribution strategy are not considered applicable to IORPs. However, other aspects, for example those referring more to the design phase, can be relevant also in the context of pension schemes. For example, that the scheme should be set up in a way that reflects the needs of the members and beneficiaries.*

*Equally, any related requirements for IORPs should consider and be adapted to the specificities of occupational schemes and the scope of the IORP II Directive. EIOPA also recognises that the pension landscape in the EU is heterogeneous. In particular, depending on the type of scheme, other entities besides the IORP, such as the employer or social partners, are usually responsible for the overall design of the pension scheme. There may also be collective bargaining partners bearing such responsibilities. The IORP may be primarily a financing vehicle that is implementing an agreement between the employer and the employees.’*

The AAE endorses EIOPA’s objective that ‘schemes are as suitable to the members’ and beneficiaries’ needs, characteristics and risk profiles as possible.’ In particular, we agree that the investment strategy and where relevant, choices offered and default investment choice, should have regard to these issues.

EIOPA proposes to introduce some wording in the Directive to require IORPs to ensure that the scheme is appropriate and suitable to members’ needs and is regularly reviewed. It is also proposed to introduce a formal duty of care ‘to ensure that every IORP acts fairly and in accordance with the best interests of members and beneficiaries, and supports prospective members, members and beneficiaries to properly assess the choices or options provided by the IORP.’

Whilst the AAE supports this objective, it is unclear at present what these duties entail, how NCAs will supervise IORPs’ approach in this area, and how much additional work will be required by IORPs to ensure compliance. The AAE believes it would be helpful to get more clarity on this through guidelines, including, but not limited to, clarifications with respect to the scheme’s responsibilities in cases the scheme’s design is dictated by other entities such as employers or social partners.

**SUMMARY | PRODUCT OVERSIGHT AND GOVERNANCE**

The AAE supports the objective of *‘ensuring that every IORP acts fairly and in accordance with the best interests of members and beneficiaries, and supports prospective members, members and beneficiaries to properly assess the choices or options provided by the IORP’* and believe that good inspiration can be found in the Product Oversight Governance (POG) rules for insurance companies.

## 5. SHIFT FROM DB TO DC

### A. DEFINITION OF DEFINED CONTRIBUTION

The AAE agrees that it is important to have clear definitions on the different types of pension schemes to aid the regulatory and supervisory frameworks as well as IORPs. It is not sufficient to just refer to DC and DB schemes as it is equally important to consider e.g. lumpsum vs annuity schemes, single/multi-employer schemes, trust vs contract-based schemes, the level of guaranteed elements, profit sharing mechanisms, member and beneficiary choices in contribution rates, investment strategies (or choices), and protection levels among other things. The AAE is keen to help with the relevant considerations in this matter.

#### SUMMARY | SHIFT FROM DB TO DC | DEFINITIONS

The AAE believes it is important to adopt clear definitions and that these cover all the different types of IORPs, distinguishing on specific features such as the level of guarantees, profit sharing mechanisms, DC/DB and level of member and beneficiary choices.

### B. LONG-TERM RISK ASSESSMENTS OF RETIREMENT INCOME RISK

The AAE believes long-term risk assessments from the perspective of members and beneficiaries of DC schemes are a useful and important tool, although we acknowledge that it may be a difficult area to address due to considerations on model complexity, model risk, communication issues and implementation costs. Additionally, it is accepted that a precise determination of members'/beneficiaries' risk tolerance may not always be possible and might only be a 'best guess'.

The key long-term risk for DC members is inadequate income in retirement, which is strongly linked to insufficient savings or inappropriate investment choices relative to their risk tolerance.

In adopting long-term risk assessments, IORPs can gain a better understanding of members' and beneficiaries' risk tolerances and savings and offer appropriate investment choices. This is particularly useful when projections are used to assess risks and the range of potential retirement outcomes, based on a number of investment strategies or investment options. Such exercises can yield meaningful insights into the capacity of members/beneficiaries for investment losses (or inadequate real returns) and can inform the design of investment strategies, the offering of investment choices, and communication to members. Communication in the context of schemes that offer investment choices is critical, so that members can make educated decisions that suit their risk profile.

The design of investment strategy can be supported by insights from such risk assessments so that it better reflects members' risk tolerances. In practice, where members have a choice, the vast majority tend to select the default investment option. Therefore, it is important that this is appropriate for all members based on a 'collective risk tolerance'. In DC schemes that do not offer investment choice but instead employ a collective investment strategy that applies to all members, considerations may be somewhat similar to the design of the 'default option'. Designing an investment strategy based on a 'collective risk tolerance' is challenging, particularly for demographically diverse schemes. This is because the strategy can prove inappropriate if it is too risky for some members while yielding an inadequate real return for others. This problem is commonly found in schemes where the average age characteristics are similar for the mass of the scheme's membership but at the same time there are younger and older individuals with varying investment needs and risk tolerances. One group, perhaps at the beginning of their careers, could favour higher risk options in pursuit of real long-term returns that support growth of retirement income. On the contrary, the ones approaching retirement would typically be interested in preservation of capital and lower volatility. In schemes with investment choice and a default option, one practical approach could be to have as the default a lifecycle strategy where the level of risk taken is higher at younger ages and reduces as retirement approaches.

It should be noted that long-term risk assessments can also be informative when assessing the level of charges in a scheme, particularly with respect to the investment options on offer. The use of projections, which are based on the investment return net of investment charges, can demonstrate the cost of different options and drive the design of cost-effective solutions.

This could be supported by the publication of specific guidelines. The AAE is keen to help with relevant considerations in this matter and on how to achieve informative models that are fit for purpose and at the same time practical to implement by IOPRs without excessive cost burden.

#### SUMMARY | SHIFT FROM DB TO DC | LONG-TERM RISK ASSESSMENTS

The AAE believes that long-term risk assessments are useful and important tools for IORPs and can support the understanding of risks in the best interest of members and beneficiaries. The main objective of such a tool should be to improve retirement outcomes and risk understanding for members/beneficiaries of DC schemes. However, we acknowledge that the implementation of these risk assessments may be challenging, due to cost but also due to the technical calculations of projections and the assumptions used. To this extent, the provision of specific guidelines on how to perform long-term risk assessments would greatly support their effective and efficient implementation.



### **C. SUPERVISORY REPORTING ON COST AND CHARGES**

EIOPA advises that NCAs require IORPs to report on an annual basis information on all costs and charges of schemes where members and beneficiaries bear risks.

The AAE is supportive of EIOPA's advice, noting the importance of transparency in cost reporting and helping members get value-for-money from their schemes (e.g., cost vs quality of services). There are always cost considerations from additional reporting, and therefore this should be achieved in a cost-effective way to reduce unnecessary reporting costs to IORPs. It is important to achieve a balance between collecting the necessary information and increasing administrative burdens on IORPs. Where possible, the reporting of information can be standardised to assist and streamline the reporting process and make use of readily available information from the IORPs financial statements.

### **D. INCREASED TRANSPARENCY ON NCA RISK ASSESSMENT FRAMEWORK**

The AAE supports more transparency on the NCA risk assessment framework and agrees with the EIOPA advice to require NCAs to publish their risk assessment framework publicly.

### **E. MEMBER AND/OR BENEFICIARY INVOLVEMENT IN IORP GOVERNANCE**

In many MS, members and beneficiaries are involved in the governance of IORPs, for example by participating within the boards or management committees that govern the IORPs. However, as EIOPA states in their Technical Advice it is not necessarily given in all MS that they are adequately represented. Members and beneficiaries should have adequate representation within their pension schemes, subject to fit and proper requirements, and the AAE is supportive of the EIOPA advice to introduce principle-based requirements for IORPs to demonstrate how members and beneficiaries had the opportunity to contribute in a meaningful way in the decision-making of the IORP that has direct impact on the members/beneficiaries themselves. This requirement is important for all pension schemes and not just for DC schemes where members/beneficiaries bear the risks.

### **F. FIT AND PROPER REQUIREMENTS**

EIOPA advises that Article 22(1)(a)(i) of the Directive be amended to make it clear that 'fitness' should be in relation to the type of IORP for which they are responsible i.e. the knowledge required to be a member of the Board/trustee of a DB plan is different, to an extent, to that needed by a member of the Board/trustee of a DC plan. The AAE agrees and supports this as a valid requirement.

## 6. SUSTAINABILITY

### A. INTEGRATION OF SUSTAINABILITY FACTORS IN INVESTMENT DECISIONS

EIOPA advises to integrate the European sustainability requirements set out in the SFDR that were also integrated into other regulatory frameworks, such as Solvency II, in the IORP II Directive, but with two exceptions:

- IORPs should not be required to provide a statement about their consideration of the adverse impact of investment decisions as currently required under Article 4(1)(a) of the SFDR.
- Consideration by an IORP of the potential long-term impact on sustainability factors should not automatically trigger the application of Article 8 of the SFDR.

EIOPA also advises to revise Article 28(2)(h) of the Directive to include in the ORA the application of scenario analysis to quantify the risk exposures to climate change. The AAE supports this proposal, provided it is applied in a proportionate manner to ensure that the burden on smaller IORPs is not excessive.

The AAE supports these proposals as being both relevant and necessary, recognising that additional costs may be incurred to achieve this, although there would be long-term benefits that justify the additional cost. Considerations on value-for-money remain relevant and should be considered when implementing any such changes.

### B. FIDUCIARY DUTIES

EIOPA advises to clarify that ‘*fiduciary duty*’ in a sustainability context should, within the boundaries of the prudent person rule, achieve financial returns in a sustainable manner and when IORPs can gauge the sustainability preferences of members and beneficiaries, IORPs shall reflect these preferences. The AAE supports this and emphasises that just because it may be challenging in certain instances to obtain information from members, this does not justify inaction or non-compliance. At the same time the AAE reiterates that information on member preferences does not imply that it should be followed blindly as the prudent person rule still applies. It is important to provide clear, transparent and concise information to members in this regard, noting any deviations between their preferences and actual investment decisions, with adequate justification.

In DB schemes, while integrating sustainability factors may align with broader ESG goals, it is important to assess the potential impact on returns. Consideration should be given to the impact on the investment strategy of a scheme from reflecting the sustainability preferences of members, which may have knock on effects and increase the cost to the sponsor of providing

the scheme. Therefore, this is a topic which requires consideration of various factors and a balanced approach that considers both sustainability and any potential impact on financial performance. It is recognised that reflecting members' and beneficiaries' sustainability preferences could be more easily addressed in DC schemes with individual investment choice although it could be more challenging to do so in DB schemes. In DC schemes that offer investment choice, ESG-rated investment options could be an important consideration, particularly for the default investment option.

We also note the importance of adhering to the prudent person rule and duty of care, ensuring that sustainability strategies provide adequate portfolio diversification.

### C. STEWARDSHIP

*EIOPA advises that 'IORPs should consider a stewardship approach to address sustainability risks in a proportionate manner, by way of engaging with investees to support the transition towards more sustainable business activities in a consistent way to comply with investment principles and serve members' and beneficiaries' best interests. This engagement should also reflect the members' and beneficiaries' sustainability preferences when IORPs can gauge the sustainability preferences of the members and beneficiaries.'*

The AAE supports this objective, recognising that for smaller IORPs a proportionate approach is essential. However, this does not imply that smaller IORPs lack responsibility regarding their investments and voting rights. Practical solutions, such as collaborating with external organisations or NGOs that provide voting recommendations, can help smaller IORPs fulfil these responsibilities when they may lack the internal capacity or resources. The AAE also agrees that this stewardship policy should be documented in the Statement of Investment Policy Principles.

#### SUMMARY | SUSTAINABILITY

The AAE supports the integration of sustainability requirements into the IORP II Directive, aligning with EIOPA's advice, recognising both long-term benefits and potential additional costs. Fiduciary duties should focus on sustainable financial returns while reflecting member preferences, although the prudent person rule remains paramount. Transparency in communication for addressing deviations from member preferences is critical. We endorse the inclusion of a stewardship policy in the governance documents as it promotes proactive risk management and aligns with evolving transition risks.

## 7. DIVERSITY AND INCLUSION

### A. D&I IN MANAGEMENT BODIES

The AAE supports the view that diversity and inclusion should lead to better management decisions and the principle that administrative, management, and supervisory bodies (AMSBs) should strive to be diverse and inclusive.

In this context we welcome EIOPA's recommendation that the Directive is amended to include the requirement that *'IORPs and, where applicable, their respective nomination committees shall put in place a policy that promotes diversity and inclusion in the management or supervisory body.'*

Notwithstanding the above, we note that the following points should be taken into consideration:

- Fitness and propriety are still a key requirement and as important to fulfil as diversity and inclusion.
- Where the membership of the IORP is not in itself diverse and inclusive, it may not be appropriate or practical to require a diverse and inclusive AMSB.

### B. REPORTING ON D&I

EIOPA has two recommendations under this heading:

- *'Member States shall require IORPs to regularly report to the competent authorities the policy promoting diversity and inclusion on the management or supervisory body and its objectives'*
- *'Member States shall require IORPs to publicly disclose the target for the representation of the underrepresented gender in the management or supervisory body, the policy on how to increase the number of the underrepresented gender in the management or supervisory body and its implementation in the annual reports.'*

#### SUMMARY | DIVERSITY & INCLUSION

The AAE supports the promotion of diversity and inclusion in management and supervisory roles. We believe that fostering such diversity enhances organisational effectiveness and governance, contributing positively to long-term sustainability.

The AAE supports the recommendations above and agrees that the Directive should promote and encourage diversity and inclusion, and to require IORPs to report on their policy and actual practice, with a comply or explain approach. Fit & Proper requirements remain a paramount consideration when addressing representation in the management or supervisory body.

## THE ACTUARIAL ASSOCIATION OF EUROPE

The Actuarial Association of Europe (AAE), founded in 1978 under the name of Groupe Consultatif Actuariel Européen, is the Brussels-based umbrella organisation, which brings together the 38 professional associations of actuaries in 37 countries of the EU, together with the countries of the European Economic Area and Switzerland and some EU candidate countries.

The AAE has established and keeps up-to-date a core syllabus of education requirements, a code of conduct and discipline scheme requirements, for all its full member associations. It is also developing model actuarial standards of practice for its members to use and it oversees a mutual recognition agreement, which facilitates actuaries being able to exercise their profession in any of the countries concerned.

The AAE also serves the public interest by providing advice and opinions, independent of industry interests, to the various institutions of the European Union - the Commission, The Council of Ministers, the European Parliament, ECB, EIOPA and their various committees - on actuarial issues in European legislation and regulation.



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