EAPSPI

Pensions for the Public Sector

Annual Report 2009

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CONTENTS

Foreword

Pensions are basically designed by the Member States, the social partners and pension providers on the basis of national legislation. However, international impacts and evolutions, notably from EU legislation, are steadily increasing and becoming more important for all pension institutions. That is why there is a need for information about these developments to create a sound basis for decisions taken by public sector pension institutions associated with EAPSPI.

Against this background, EAPSPI's working groups have summarized – for the first time – the most important evolutions of the year 2009. The basis of this report is the findings of EAPSPI's working group sessions that were presented to all EAPSPI subscribers in the open information meeting on 15 October 2009, preceding the Annual General Meeting.

This annual report of EAPSPI's working groups is therefore addressed to all those who wish to get rapid access to information about the most important international and EU developments in the past year. Without going into detail it aims to outline the major evolutions. By presenting this report we want to encourage further EAPSPI members to take part in the working groups in order to promote information exchange between members and within the association.

2009 was notably marked by the continuation of the financial crisis and its effects on pension schemes. Funded schemes in particular were – and are – still concerned by the turmoil on the financial markets and by an often huge decrease of their assets. The EU legislator therefore has undertaken various initiatives to stabilize the financial sector in general and the pension sector in particular to avoid similar critical situations in the future. But the crisis was not the only important issue for public sector pension schemes in 2009. Also, questions of cross-border activities, taxation issues and the jurisprudence of the European Court of Justice (ECJ) have affected EAPSPI's members and are hence outlined in this brochure.

We hope that this report will help to achieve a better understanding of the sometimes complex European issues. We finally would like to express our thanks to all members of the working groups and we are looking forward to their future activities and initiatives.

Wolf R. Thiel
Chairman

Hagen Hügelschäffer
Secretary General

GENERAL ASPECTS OF THE FINANCIAL CRISIS REGARDING PENSIONS

General aspects of the financial crisis regarding pensions

The crisis of 2008/2009 has heavily struck the financial markets and hence the pension sector as well. But the effects on individual pension institutions vary according to the national origin and the design of the pension scheme.

Two kinds of pension funds can be distinguished according to the financing method, funded and pay-as–you-go (PAYG) schemes. Both of them will face hard measures in the near future in order to ensure financing and sustainability.

When talking about sustainability, funded and PAYG schemes will be confronted with different evolutions:

- As far as funded schemes are concerned, pension contributions were expected to rise even before the global financial crisis, due to solvency requirements and the International Financial Reporting Standards (IFRS) rules, added to the increased longevity of the population. Apart from that, there is a sustained financing shift from employers to employees, resulting in an increasing importance of DC-schemes instead of DB-schemes in many European countries.
- In the case of PAYG schemes, the risks stem from the aging of the population and increased longevity. Indeed, in 30 years time the dependency ratio measuring the population older than 65 will change from 4-1 to 2-1.

Looking at financing, the crisis has had the following effects on funded and PAYG schemes:

- Funded schemes are faced with diminishing assets due to price drops combined with low discount rates which raise liabilities and together cause unsustainable funding ratios. This demonstrates that funded pension schemes are vulnerable to volatility, on both liabilities and assets sides. It is also said that due to the fact that some European countries are not taking the necessary measures to balance their public accounts, inflation could spread throughout Europe over the coming 5 to 10 years, this being a real problem for funded schemes.

- PAYG schemes are not affected by inflation as funded schemes, but for schemes financed by general taxation, falling tax incomes stemming from the crisis hit public accounts, leading to huge deficits (expected 6% for 2009 and 7.6% for 2010) which together with demographic changes end up in a heavy financial burden for future generations as well as first pillar pension cuts.

Therefore, short or long term effects of the financial crisis vary depending on the structure of the scheme, the Member State where they are located and its public expenditure policy. But pension funds are affected by the crisis in a different way than other financial institutions – as for instance banks – are affected. Pension funds balance sheets have a much longer term nature (both liabilities and investments). Furthermore pension funds did not generally invest so heavily in toxic assets. Because of the long-term nature of pension funds they are not as directly affected by the credit shortage as banks.

If pension schemes are classified according to the risk allocation, they can be divided as defined benefit (DB) or defined contribution (DC) schemes.

- In the case of DB schemes, the current pensioners do not face any problems deriving from the crisis. But the situation is different for pensioners in the near future. Next to the recent negative investment results they are also faced with very low interest rates used as discount rates, meaning low pension income out of the already low investment results.

- Current and future pensioners of DC schemes face both reduced indexations and even pension rights. As a result future pensioners will probably need to work longer in order to obtain an equivalent pension, putting more pressure on unemployment among young workers.

There is a study of the UK National Association of Pension Funds (NAPF) which shows that UK employers tend to reduce pension costs and risks by moving from DB to DC schemes. With respect to the employees' perspective, confidence in pensions has been struck, and is declining in time.

As a result of the crisis, the following four new dimensions have emerged, among others, into the discussion:

- Intergenerational fairness and solidarity: Who is going to pay what in terms of contributions, and who is going to receive what in terms of pension results?
- Risk awareness among beneficiaries: There is a trade off between contributions and rate of return/risk.
- New supervisory rules: Is insolvency protection possible? A system of prudential regulation should be anti-cyclical and

framed with a comprehensive point of view in mind.

- Confidence or trust: Pension funds should favour transparency so the members regain confidence in the pension system. It is necessary to tell pension schemes members what has to be done for the recovery and what risks it means for them as future beneficiaries.

Cyril Savelkoul
APG, The Netherlands

EFFECTS OF THE CRISIS ON ASSET MANAGEMENT

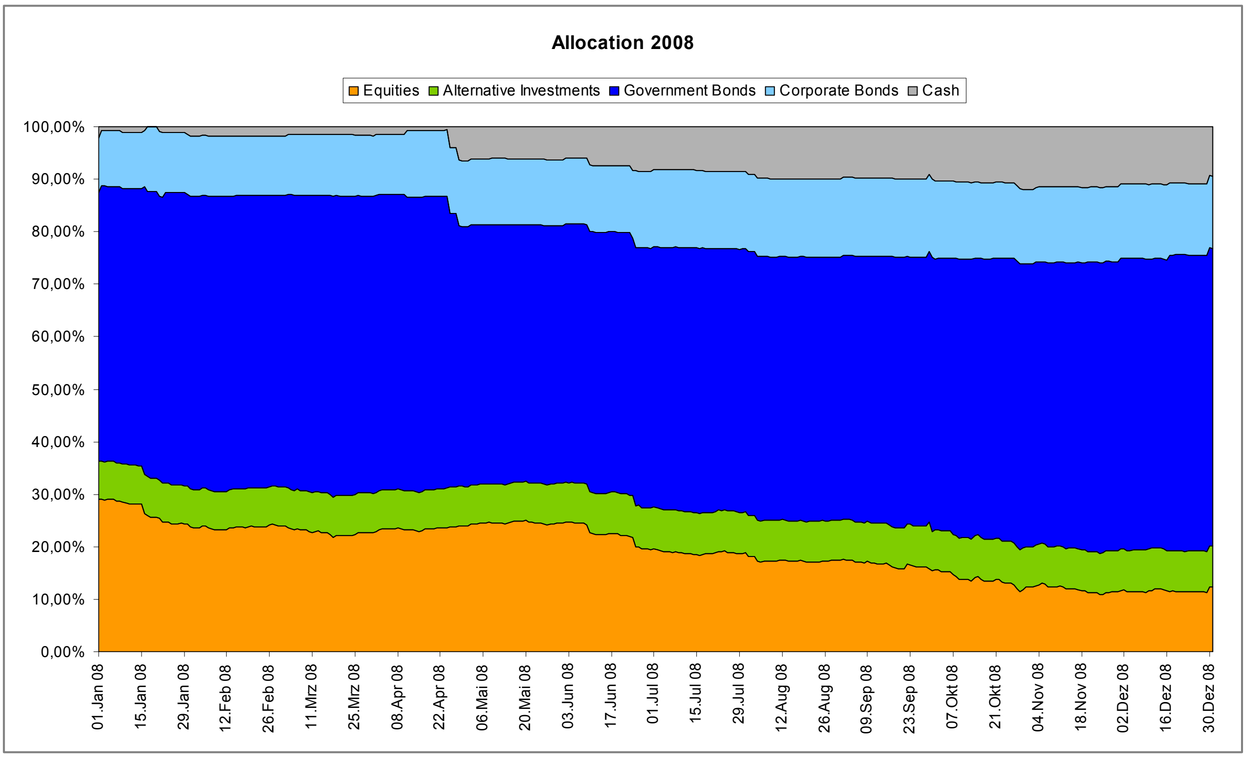
Effects of the crisis on asset management

This issue was of paramount interest for EAPSPI and its members during the last year. In order to get an overview about the effects of the crisis on the daily business of public sector pension schemes, a one-day seminar was scheduled on 5 March 2009 in London. Furthermore, this issue was the focus of the new Asset-management working group that started its activities after its formal creation at the Annual General Meeting in October 2008.

London seminar 5 March 2009

This event was organized by EAPSPI's member DCLG (Department of Communities and Local Governments) with EAPSPI member representatives from Norway, Sweden, United Kingdom, The Netherlands, Germany, Austria and Spain presenting their experiences. Even if the situation was different in all these countries, some common evolutions occurred. The basic, perhaps predictable, reaction of pension fund managers was to move away from equity to cash (safety).

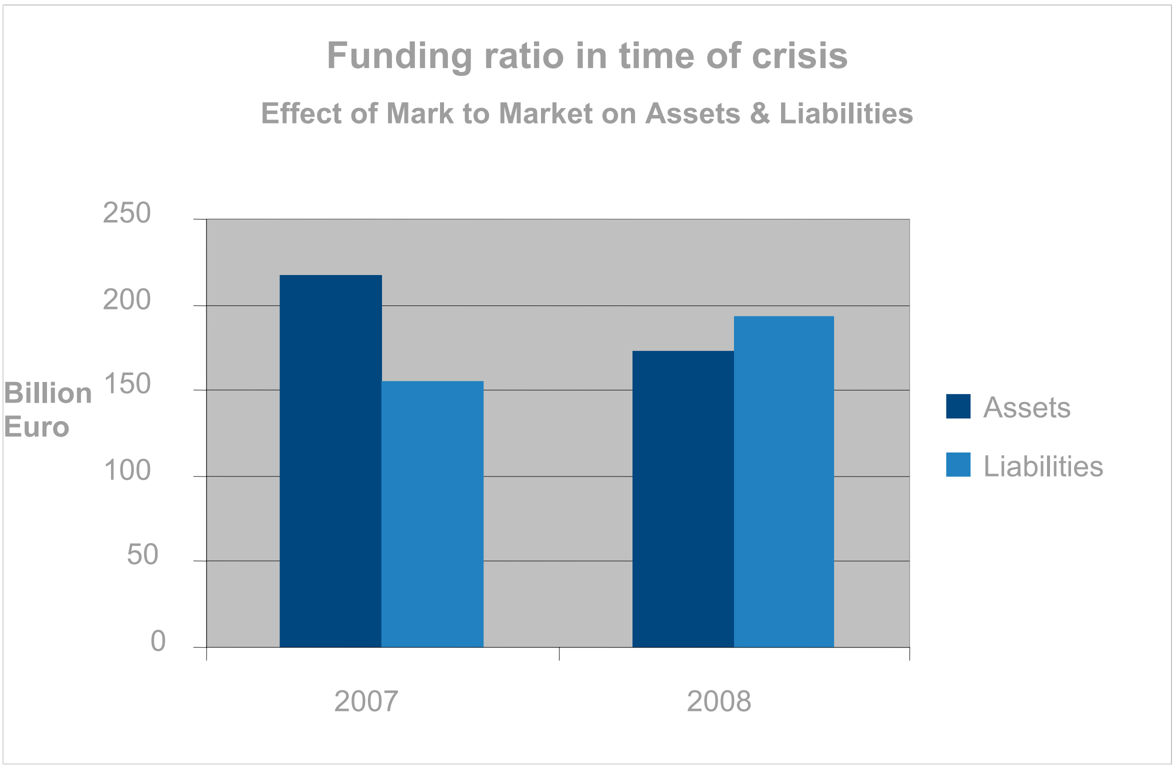
Reducing equity holdings: changes in asset allocation in 2008



Source: Member presentation, EAPSPI London seminar, 2009

The main problems observed were the lack of liquidity in the markets and the fall of interest rates due to the intervention of central banks in order to save the banking system, which dramatically affected the valuation of liabilities – pension funds appear as innocent victims of the affair. The problem was particularly acute in funds using mark to market valuation for calculation of liabilities as the diagram shows.

The effect of the crisis on the funding ratio: falling assets and rising liabilities



Source: Member presentation, EAPSPI London seminar, 2009

Illustration of the effect of the discount rate on the funding ratio (constant level of assets) crisis on the funding ratio: falling assets and rising liabilities

Interest rate for liabilities	Funding ratio
3,6% (swap rate end 2008)	90%
4% (former fixed discount rate)	95%
5%	110%
6%	126%

Source: Member presentation, EAPSPI London seminar, 2009

Among points raised during the seminar, a paradoxical situation was noticed well illustrated by the following two questions:

- **What happens during a financial boom?** Market and media pressures encourage an increase in the equity proportion of the portfolio, solvency rules allow for high equity exposure due to decreasing liability burden as interest rates rise, and funds with low risk profiles are criticised for their poor yields.
- **What happens during a financial crisis?** Pro-cyclical measures such as sharp reductions in equity exposures due to increase in liabilities, sale of equities into falling markets accelerate falls, and funds with low risk profiles are described as lucky.

Asset-management working group

The group is a forum of experts to promote in-depth exchange of best practise in order to help members to improve their asset management and to learn about the challenges and solutions for other institutions. The initiative was based on a proposal of EAPSPI's Board of Directors at the beginning of 2008, after the subprime crisis burst but some time before the worsening of the current financial crisis. Therefore, the working group and its activities are particularly important for funded schemes that are nowadays faced with sometimes considerable losses over a short period. The group's work also concerns those pay-as-you-go schemes that are accumulating reserves as financial buffers or that intend to move to a funded system in the medium- or long-term. But the scope of the working group's activities is not restricted to the sole issue of assets even if the name of this working group might lead to this conclusion. The ongoing discussion about new supervisory rules – either in the context of the Solvency II Directive or of the revision of the IORP Directive will have to be observed and analysed thoroughly by this group.

Although EAPSPI's member organisations all provide pension services for the public sector, there are large difference as to their nature (special basic schemes of the 1st pillar or supplementary schemes of the 2nd pillar as well as distinction between DB- and DC-schemes), as to its financing techniques (PAYG or funding), supervisory rules, number of affiliated members and organisation as national or regional pension institutions. These differences affect *inter alia* asset/liability management, asset allocation, eligible assets, prudential supervision, solvency requirements and accounting rules. Despite this diversity, the members of EAPSPI face the same basic challenges (e.g. maintaining financial equilibrium beyond the short-term); they invest in the same markets, place their assets in similar investments and pay close attention to resources devoted to this function.

Starting from these considerations, the working group first defined the following areas that are to be debated although every member is aware of the fact that these issues can only be handled in an exhaustive manner step by step and not within a short period. These areas are:

- Socially Responsible Investment (SRI) with the subtopics Real estate SRI and communication on the SRI policy and engagement. A couple of years ago SRI was a kind of “gadget” to be discussed as a possible policy, while nowadays the idea is emerging that any sound investment should be SRI in some way.
- Strategic Asset Allocation Process.
- Asset management techniques.

- Risk management. If the basic mission of a pension fund is providing the best pension for the best price, it can be said that risk must be accepted in order to deliver the best pension.
- Certain overarching issues (e.g. OECD and other guidelines on Pension Fund Asset Management; Prudent person principle).

The turmoil on the financial markets has perhaps brought forward the need to consider pension investment in a way that is consistent with the long-term aim and horizons of our institutions. These different areas of work will allow the group to explore specific features of the role of EAPSPI members as long-term investors. Especially in view of the current crisis, these issues will provide sufficient material for the future.

Conclusion

The information exchange about the effects of the crisis on European public sector pension institutions has revealed the following major aspects:

- EAPSPI brings together a truly diverse group of pension managers due to the size, type of scheme (DB, DC scheme) and the level of funding.
- Its members are long-term investors with a social responsibility of providing a pension for future retirees.
- Despite the global nature of financial markets, national regulations seem to play a significant role in the asset management process, notably prudential rules on discount rates and solvency ratios as well as accounting rules.

Tim Pullman
CDC, France

NEW REGULATORY FRAMEWORK FOR IORPS

New supervisory framework for IORPs

This section contains:

- A summary of the developments in 2008/2009 regarding the Solvency II Directive and its consequences for institutions of retirement provision (IORPs).
- The current discussion on whether new harmonized solvency rules will be elaborated for IORPs in the near future.
- New supervisory architecture, conceived by the Commission, as an output of the "de Larosière-report".
- Possible insolvency protection for IORPs and some summarizing remarks.

Solvency II and IORPs

The Council and the European Parliament reached a compromise on 23 March 2009 on the Solvency II Directive. The European Parliament adopted this Directive on 22 April and the Council on 5 May, just before the parliamentary elections in June. Supplementary pension schemes of the second pillar remain excluded from the scope of the directive. Therefore, Solvency II will not be applicable to IORPs.

However, this compromise stipulates that the Commission, supported by CEIOPS, should review the IORP Directive[1] as soon as possible in order to create a harmonized framework for supervisory rules for IORPs at EU level. This framework should take into consideration the differences between the second and the third pillar. Consequently, the application of any Solvency II rules should not be prejudged in this process.

New solvency rules for IORPs?

The Commission launched a public consultation from September to November 2008 on whether solvency rules for at least some IORPs (notably those without a sponsoring institution or those offering cross-border services) should be harmonized.[2] Altogether, 60 institutions participated in this consultation. The results were summarized in a Feedback Statement of the Commission of 16 March 2009.

[1] Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision

[2] Consultation of 3 September 2008 on the Harmonisation of Solvency Rules applicable to Institutions for Occupational Retirement Provision (IORPs) covered by Article 17 of the IORP Directive and IORPs operating on a cross-border basis (Ares (08) 14767)

The key messages of EAPSPI in this consultation are as follows

1. EAPSPI first underlines that this consultation is of paramount importance For all funded members since it will have a significant impact on the further discussion about future supervisory rules at EU level.

2. EAPSPI would like to point out that this consultation would have been better based on a broader view allowing the Commission to get a complete overview of the various solvency rules of IORPs as well as different security mechanisms in Member States. Instead, the scope of this consultation is focused on pension schemes in some selected countries.

3. EAPSPI members are of the opinion that there is a fundamental difference between IORPs and insurance undertakings in terms of pension products and of steering instruments. Therefore, EAPSPI members believe that IORPs, i.e. institutions of the second pillar, should be treated differently to insurance undertakings of the third pillar since workplace (or occupational) pension provisions are fundamentally different to individual insurance contracts.

4. The IORP Directive already provides common minimum standards and implementation was only completed in 2007 in EU Member States. Therefore, further legislative measures to modify these rules are premature. A further harmonization of solvency rules for funded schemes on a European level is therefore not necessary at the moment.

5. With respect to the demographic evolution in Europe, EAPSPI is of the opinion that IORPs will be able to help to solve future problems of the State-run first pillar schemes and that the IORP Directive will help to promote this development.

6. EAPSPI would like to mention that cross-border activities have had insufficient time to develop significantly since the implementation of the IORP Directive. Even if cross-border activities are expected to increase within the coming years, EAPSPI does not believe that they will develop significantly among public sector pension schemes.

7. EAPSPI comes to the conclusion that, beyond the scope of this consultation, there are further common principles that are applicable both to funded IORPs (as far as funding and security mechanisms are concerned) and to unfunded IORPs (as far as security mechanisms are concerned). These shared common principles can be outlined as follows:

- The main target of IORPs is the protection of the interests of the beneficiaries with regard to their pension commitment.
- In order to avoid any market distortions it is evident that in terms of funding and/or security mechanisms, the same rules should be applicable for pension products that are the same and delivered by insurance undertakings and by IORPs. This, however, requires the products to be truly comparable.
- In most countries, individual pension arrangements delivered by insurance undertakings are entirely different to pension products delivered by IORPs.
- The interests of the beneficiaries can also be ensured by other mechanisms than supervisory rules that are currently under discussion in the debate on Solvency II. In particular, labour law provides a large degree of protection in many Member States. For this reason, labour law, and particularly collective labour law, may be called "consumer protection law in the field of occupational pensions".

The next step was a public hearing organized by the Commission on 27 May 2009 in Brussels. At this event, four different panels dealt with the following questions:

- Need for harmonisation of solvency rules for IORPs at EU level.
- Level playing field between pension funds and insurance undertakings.
- Technical provisions and solvency rules in a cross border context.
- Other questions, such as investment rules for defined-contribution schemes, occupational pension provision in different Member States; impact on the overall pension system.

The main opinions of the panellists and other participants can be outlined as follows:

Especially pension funds' representatives, but also the employers' stakeholders, were against any further harmonisation. They underlined the fundamental differences between second and third pillar institutions especially by highlighting the social mission of IORPs for supplementary old age income alongside the statutory first pillar schemes. IORPs are furthermore not-for-profit organisations that have different security mechanisms in the Member States. Finally, their different structures would complicate any harmonization at EU level.

The protagonists of a harmonized EU framework for solvency rules mainly come from the insurance industry. Their argumentation is mainly based on the formula "same risk – same capital". In their opinion, IORPs offer the same products as third pillar institutions. Therefore, the Solvency II Directive now has created an unjustified different treatment of insurance companies (falling under the scope of the Solvency II Directive) and second pillar institutions that remain excluded. Therefore, harmonization should take place. Yet, the undeniable differences of IORPs and insurance undertakings should be taken into consideration.

Against this background and the tendencies in the further discussions at EU level, a revision of solvency rules for IORPs is probable at a medium-term horizon. A further element in this context could be the new "duration based equity-risk sub-module" (also called "Solvency II light model") for some kinds of insurance undertakings offering occupational pensions under specific conditions laid down in Art. 305b of the new Solvency II Directive. A basic political decision is awaited after the election and the introduction of the new commissioner for the DG Internal Market that is competent for this dossier. A draft directive might be published by mid 2011. A transfer into national legislation could thus be achieved by the middle of this decade.

New supervisory architecture at EU level

Apart from the discussion about a new solvency regime for IORPs, the Commission is working on a new supervisory architecture at EU level. At a first step, the Commission established a high level expert group in order to reorganise the supervision of European financial institutions and markets. The fruit of this group is its final report of 25 February 2009 that is called, from the name of its chairperson, the "de Laroisière report".

The "de Larosière report"

The Commission President Jose Manuel Barroso set up this high level expert group in October 2008 to provide recommendations on strengthening European supervisory arrangements. The group was chaired by Jacques de Larosière, former managing director of the International Monetary Fund (IMF).

The mandate of the "de Larosière group" covered three main areas:

- Organisation of the supervision of European financial institutions and markets to ensure the prudential soundness of institutions, functioning of markets and protection of consumers.
- European cooperation on financial stability oversight, early warning mechanisms and crisis management.
- Cooperation of European supervisors with other major jurisdictions to ensure stability at the global level.

The group issued its report on 25 February 2009 and called for a European System of Supervision: "Financial regulation and supervision have been too weak or have provided the wrong incentives", the Chairman of the group Jacques de Larosière stated in its opening remarks of the report. "In essence, we have two alternatives: the first '*chacun pour soi*' (beggar-thy-neighbour) solutions; or the second - enhanced, pragmatic, sensible European co-operation for the benefit of all to preserve an open world economy".

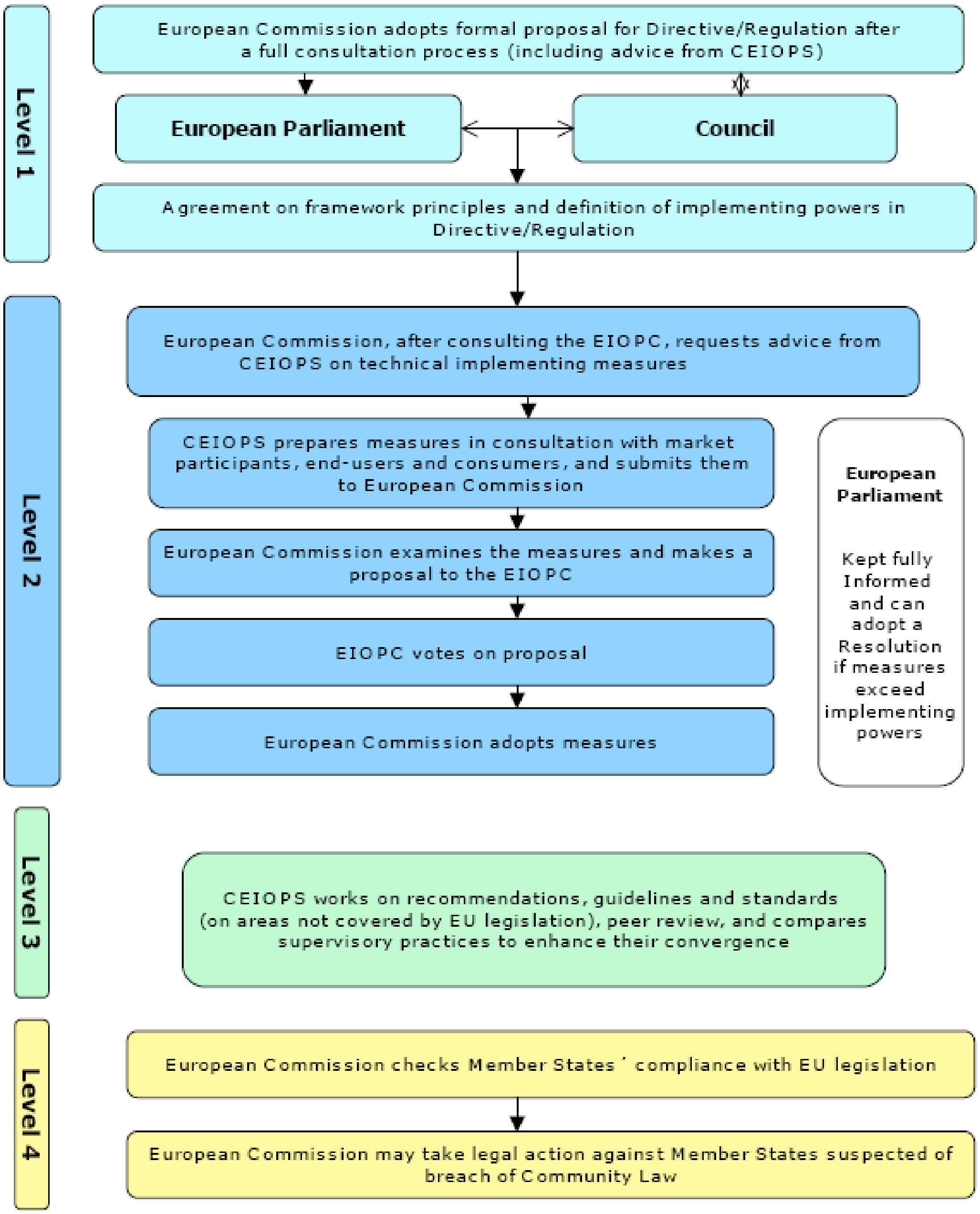
The Group made some 31 recommendations to strengthen European supervisory arrangements covering all financial sectors. However, the specific pension sector is not mentioned once in the 85 page report.

The “de Larosière report” was followed by two consultations in spring 2009. On 23 September, the Commission published several draft regulations to establish the new supervisory framework. This draft legislation proposes three different bodies: European Systemic Risk Board (ESRB), European System of Financial Supervisors (ESFS) and finally a Board of Appeal.

- The European Systemic Risk Board (ESRB) should monitor and assess risks to the stability of the financial system as a whole ("macro-prudential supervision"). It should provide early warning of systemic risks that may be building up and, where necessary, recommendations for action to deal with these risks. The ESRB will not have any binding powers to impose measures on Member States or national authorities. It has been conceived as a "reputational" body that should influence the actions of policy makers and supervisors by means of its moral authority. The main decision-making body of the ESRB will be the General Board (61 members), assisted by the Steering Committee (12 members), the Secretariat, and the Technical Advisory Committee. The Board will be located in Frankfurt and will be financed and supported by the ECB.
- The European System of Financial Supervisors (ESFS) will be competent for the supervision of individual financial institutions ("micro-prudential supervision"). It will consist of a network of national financial supervisors working in tandem with new European Supervisory Authorities (ESAs). However, everyday supervision will be executed by the national supervisory authorities. The ESAs will be created by the transformation of the existing three “Level-3 Committees” (often abbreviated as 3L3-committees) of the Lamfalussy-structure for the banking, securities and insurance and occupational pensions sectors. The current Level-3 Committees are the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).

The Lamfalussy structure

Lamfalussy – Model from the Perspective of CEIOPS



Source: CEIOPS website: www.ceiops.eu

The new European Supervisory Authorities are:

- The European Banking Authority (EBA).
- The European Securities and Markets Authority (ESMA).
- The European Insurance and Occupational Pensions Authority (EIOPA). According to the draft regulation of September 2009, EIOPA should have – among others – the following competences:

    - development of binding technical standards and interpretative guidelines that are to be approved by the Commission;
    - development of guidelines and recommendations for national supervisory authorities to ascertain the uniform application of EU law;
    - binding decisions in case of disagreement within colleges of supervisors in case of cross border IORPs;
    - intervention in case of manifest breach of EU law. The Commission should then take a binding decision to national authorities on recommendation of EIOPA;
    - coordination in the case of crisis;
    - collection of micro-prudential information.

The ESAs will be Community bodies with a legal personality. The ESAs will take on all the tasks of the existing European supervisory committees. In addition they will have – as shown above for EIOPA – significantly increased responsibilities, defined legal powers and greater authority. The main decision-making body of each ESA will be its Board of Supervisors, consisting of the heads of the relevant national supervisors as well as the Chairperson of the respective Authority. The day-to-day management of each Authority will be in the hands of an Executive Director. It is proposed to maintain the present place of residence of the existing European committees of supervisors to allow a fast and effective transition to the new regime.

- A Board of Appeal that ensures that any natural or legal person, including national supervisory authorities, may in first instance appeal against a decision by the ESAs. The Board of Appeal shall be a joint body of the three ESAs, i.e., it will deal with issues related to banking, insurance and securities. The Board of Appeal will have six members and six alternates with relevant knowledge and experience, excluding current staff of the national supervisory authorities or other national or Community institutions involved in the activities of the Authority.

This new supervisory architecture should be implemented by the end of 2010. Complete implementation, however, requires an adaption of the substantive law. Therefore, the Commission published a draft of an "Omnibus-directive" on 26 October 2009 (2009/0161 COD), by which 11 directives related to financial services are to be modified, including the IORP Directive. This draft "Omnibus-directive" modifies Art. 13 (Information to national supervisors) and Art. 20 (Cross-border activities) of the IORP Directive. The amendments in the version of 26 October 2009 foresee that EIOPA should develop draft technical standards for information provided to the national supervisory authority and for cross-border activities. These proposals are to be submitted to the Commission before 1 January 2014.

Insolvency protection

Another issue under discussion is insolvency protection as a further safety net for the beneficiaries of pension funds in order to protect them from insolvency of the employer and/or the pension fund. These measures are discussed apart from the already mentioned solvency rules. The starting point is the *Robins*-case (C-278/05) of the ECJ that has driven the Commission to undertake further investigations whether and how the Member States have ascertained the insolvency protection within the second pillar.

The Robins case (C-278/05)

Mrs. Robins and other claimants were former employees of a British company which went into liquidation in April 2003. They were members of pension schemes that had been terminated in July 2002 and were in the process of being wound up. There were insufficient assets to cover all the benefits of all members, and the benefits of non-pensioners will therefore be reduced.

Under the legislation in force in the United Kingdom prior to the ECJ-decision, Mrs. Robins and the other claimants did not receive all the benefits to which they were entitled. Some claimants received only between 20% and 49% of their benefits.

The British High Court of Justice asked the ECJ whether Article 8 of the Directive 80/987/EEC of 20 October 1980 (later replaced by the new EC Directive 2008/94/EC of 22 October 2008) regarding the harmonisation of national rules of the Member States for the protection of supplementary pension rights in case of insolvency of their employers commits any Member State to ascertain the full coverage of all pension rights of the concerned persons.

The ECJ came to the conclusion that Article 8 does not stipulate any obligation for a Member State to fund accrued pension rights or that these rights must be funded in full. Article 8 only foresees a minimum protection of pension rights. Yet, a loss of 50% does not fulfil this requirement of a minimum protection. A liability of the Member State would, however, require that the respective directive would be sufficiently clearly formulated, which is not the case.

Against this background, the Commission launched a public call for tender for a deepened analysis in April 2009 as to:

- protection of employees and retired persons against the risk of under-funded schemes. However, PAYG schemes are not covered by this study.
- guarantee of unpaid contributions to pension schemes.
- cases where the supplementary pension scheme is managed by the employer himself.

The results of this study are expected by the end of 2010.

In spite of the study, CEIOPS published a study on 30 June 2009 about insurance guarantee schemes ("CEIOPS input to the EC work on Insurance Guarantee Schemes - IGS). This report contains 13 recommendations for a future regulation for IGS. CEIOPS comes to the conclusion that at a first step a minimum harmonisation should be achieved that is to be enlarged at a later stage. However, IORPs should be excluded. The reason is given in another CEIOPS document of 15 June 2009 called (Note on Member States' responses to the questionnaire on Pension Guarantee Schemes - PGS). This report lists the basic features of the second pillar schemes and of pension protection in the different Member States. On the basis of these facts, CEIOPS concludes that harmonized rules for PGS at EU level would come too soon because of the following reasons:

- diversity of the pension plans (DB and DC) as well as of prudential rules and protection mechanisms of social and labour law.
- still marginal implementation of PGS in the European Member States. Therefore the overall introduction of PGS is preferable to the implementation of harmonized EU rules at the present time.
- any introduction of a PGS needs to be assessed against other protection mechanisms built in to the regulatory framework
- additional costs of insolvency protection, which might end in diminished pension benefits.

Conclusions and outlook

All the above outlined measures are driven by the intention of the Commission to obtain a high level of beneficiary protection through a mixture of several security mechanisms. This is the background of possible new solvency rules, a new supervisory architecture, and perhaps at a later stage, by new insolvency protection. All these strands might be part of a green paper of the Commission on the European pensions' framework that is awaited for the second half of 2010.

But also the Spanish EU Presidency of the EU during the first six months of 2010 wants to focus on the promotion of the de Larosière agenda to reform the financial system within Europe and promoting the creation of the ESRC and the ESAs. Against this background, intensive discussions are expected within the next months. Under these circumstances, the challenge for the IORPs is to communicate correctly their differences regarding other financial services providers.

Green and White papers

A **Green paper** is a discussion document of the Commission to stimulate a broad-based public discussion. A **White paper** is a follow-up document containing official proposals for future (legal) initiatives.

Hagen Hügelschäffer
EAPSPI

CROSS-BORDER ACTIVITIES

Cross-border activities

Although the business area of pension institutions is mostly the national (or even regional) market, cross-border questions are becoming increasingly important. In order to foster cross-border services, the IORP Directive provides the legal framework for institutions for occupational retirement provision (IORPs) to offer their services outside their home countries and hence to undertake a first step on the way to a European internal market for occupational pensions. But the field of cross-border pensions is not limited to the perspective of the IORP. It also includes the question of portability (or transferability) of pension rights once a worker moves to another Member State.

Report of the Commission on the implementation of the IORP Directive

The IORP Directive explicitly sets out reporting requirements for the Commission on four key aspects: a regular report at least every two years on the rules regarding the calculation of technical provisions, a specific report within four years on the application of investment rules, on progress achieved in the adaptation of national supervisory systems and on cross-border custodianship.

The Commission presented its report on 30 April 2010 that had been elaborated together with CEIOPS. The report contained the following conclusions:

- There is no immediate need for legislative change.
- As a result of the examination previously carried out by CEIOPS, there is a need to continue monitoring these aspects of the IORP Directive.
- The Commission and CEIOPS will continue monitoring the operation of investment rules in order to ensure a uniform application of the IORP Directive.

CEIOPS 2008 Report on Market Developments

This document of 11 November 2008 provides a general overview on the cross-border developments for IORPs after the implementation of the IORP Directive by Member States. A prior survey was carried out in 2007. Starting from 48 cases of IORPs with cross-border activity in the EEA described in the first report, there has been a 46% incease to 70 cases in nine states, instead of the five before. Data will be updated by the Occupational Pensions Committee of CEIOPS on an annual basis in order to be able to better follow and understand market developments.

What is CEIOPS?

CEIOPS is the Committee of European Insurance and Occupational Pensions Supervisors. It was established under the terms of the European Commission Decision 2004/6/EC of 5 November 2003, currently repealed and replaced by Decision 2009/79/EC. It is composed of high level representatives from the insurance and occupational pensions supervisory authorities of the European Union Member States. The authorities of the European Economic Area Member States also participate in CEIOPS. Its Secretariat is located in Frankfurt am Main.

Source: CEIOPS website: www.ceiops.eu

Portability of supplementary pension rights

Free movement of persons is one of the fundamental freedoms granted by community law. However, mobile workers face practical problems as to their accrued supplementary pension rights when moving to another country. Due to the increasing importance of supplementary pension schemes it is important to have a closer look at this issue.

In aging societies – as is true for Member States of the European Union – supplementary pensions frequently are a key element of sustainable pension systems. As providers of supplementary pensions for the public sector, EAPSPI's members are therefore in particular concerned with this issue.

At EU level, the so-called "Portability Directive" – if ever enacted – will probably not provide any solution since the actual portability (or transferability) has been deleted from the last versions that were debated. Therefore, solutions outside the legislative process will have to be developed to promote portability of supplementary pension rights. During recent months this issue once again has awoken the interest of the European Commission in the case of researchers and scientists who frequently change jobs and the country especially at the beginning of their career and hence often suffer serious losses of their supplementary pension rights. Since researchers and scientists are often insured in public sector pension schemes, EAPSPI, the German Rectors' Conference (HRK) and the European Commission already have started an exchange of ideas to find a solution.

EAPSPI's working group on Portability is therefore exploring possible solutions on portability that can be found in Europe. The basis of the current work is EAPSPI's "Portability Report" of 2007 that favours the concept of "transfer circles" as a network of similar and comparable pension schemes as a first step to solve the transfer problem within Europe.

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TAXATION INCENTIVES FOR PENSION POLICIES IN EUROPE

Taxation incentives for pension policies in Europe

EAPSPI's working group on Taxation has carried out an initial survey into scheme practice in the use of fiscal policy to encourage higher savings or improve better choice, in order to answer the question of "does tax relief work?" Responses to the survey were analysed in order to chart practice across a range of schemes in the use of taxation policy, levels of savings, examples of improved choice and how retirement plans are changing.

Although only 10 schemes from 7 countries took part in the initial survey some interesting findings have come to light and it is hoped to undertake further research next year. The early findings are shown below:

Contributions

Where members are permitted the opportunity to make additional contributions, there is some evidence that members take advantage of such a facility. If the opportunity to make additional contributions is combined with flexibility of choice (contributions to a range of schemes for example) then the survey tends to indicate that members will pay more.

Accrual

The number of members attracted to the possibility of accruing for extra years (beyond what is required for a full pension) even when the scheme allows such an option is not high. This suggests that members want to retire as soon as possible.

Lump Sums

Where the scheme offers the facility of a tax free lump sum (either as a right or in exchange for pension) then members appear to support this option. This does offer a reduction in costs to the pension scheme because by taking a lump sum at retirement the future liabilities of the scheme are reduced.

Workforce Retention

The facility to 'wind down' to retirement by taking part pension and continuing to work is something favoured by a number of members which in turn allows the employer to retain experience.

Further research next year, in particular in schemes with different taxation models, will consider questions such as:

- Do only the well paid make additional contributions?
- Do the low paid prefer lump sums to pensions?

- Are partial retirement policies the domain of senior staff?
- Does the age of a member influence the choice?
- If tax relief is not available do members make additional contributions?

It is the aim of the group to prepare a paper which will attempt to answer the question, does tax relief work. This will also help clarify whether tax relief influences individual choice.

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JURISPRUDENCE

Jurisprudence

In 2009, the European Court of Justice (ECJ) handed down several judgements which affected (public sector) pension schemes. Further cases are still pending or were officially closed.

Age and gender discrimination

Age Concern England (C-388/07): Similar to the previous Palacios de la Villa-case (C-411/05), the ECJ stated that automatic retirement at the age of 65 does not violate EU law if objectively and reasonably justified by a legitimate aim if it is appropriate and necessary. Such a legitimate aim can be – for instance – the employment policy of a country.

"**Dentist case" – C-341/08** (Domnica Petersen versus Berufungsausschuss für Zahnärzte für den Bezirk Westfalen-Lippe): Under German law, there is a general rule that the licenses which enable doctors and dentists to practice must expire and not be renewed when they attain the age of 68. The plaintiff, a dentist, complained that the German law was incompatible with Directive 2000/78/EC[3] that prohibits, inter alia, employment discrimination on grounds of age.

The German authorities were of the opinion that this rule was a proportionate means of achieving a legitimate aim, i.e. preserving the financial balance of their statutory health insurance scheme and ensuring opportunities for younger people to become dentists. Both the Advocate General and the ECJ accepted only the argument of ensuring opportunities for younger people as a legitimate aim. Since the former argument of securing public health was not accepted either by the Advocate General or by the ECJ, the German government does not refer to it any longer. In view of this decision, Germany is planning to abolish the law in question with retroactive effect to January 2008.

Infringement procedures against Italy (C-46/07) and Greece (C-599/07): In both cases, there was a different retirement age for men (age 65) and for women (age 60). According to the ECJ, such a different treatment violates Art. 141 EU Treaty that is applicable in this case even if both pension schemes are special schemes for civil servants and hence comparable to the general old-age pension scheme that may still apply different retirement ages according to the Directive 79/7.

[3] Council Directive 2000/78/EC of 27 November 2000 establishing a general framework for equal treatment in employment and occupation

"Riester pension" (C-269/07)

Some of the regulatory provisions of the German "Riester pension" savings model violates European law. This was observed by the ECJ in its ruling of 10 September, 2009. The German lawmaker must also allow cross-border commuters to benefit from the "Riester pension" savings system. Moreover, moving to another country will no longer compel workers to refund the allocated aid. Finally, state bonuses for purchasing dwellings must also be paid if it is located outside the country. Therefore Germany has to modify its income tax law. The Federal Ministry of Finance is currently analysing the ruling of the Court in order to propose the required tax law amendments.

"Riester" state aid consists of tax breaks and state subsidies during the savings phase and postponed taxation in the pension payment phase. This system was put in place at the beginning of 2002 to cushion the impact of future drops in first-pillar pensions by creating a funded pension system. Since the creation of the system, over 12.5 million people have taken out a "Riester" contract in Germany. In 2008, the amount of subsidies granted by the state reached 1.4 billion Euros for this year alone.

Collective agreement and European call for tender (C-271/08)

The object of this infringement procedure against Germany is a collective agreement in the public local sector about deferred compensation. According to the German terminology, deferred compensation is the transfer of parts of the salary into additional pension rights on a voluntary decision of the employee alone. The contentious collective agreement stipulates that only local sector pension institutions, savings banks and local insurance companies are service providers; thus excluding any other institutions of the second and third pillar.

The Commission is of the opinion that the designation of these service providers would violate the Directive relating to the coordination of procedures for the award of public service contracts (Directive 20004/18/EC) since deferred compensation falls under the scope of this Directive. Local government authorities furthermore correspond to the concept of public contracting authorities. This position is contested by the German government that is of the opinion that the conversion of earnings into pension rights does not constitute a service contract covered by this Directive but a materialisation of the employment contract that is explicitly excluded from its scope. Public employers are therefore not public contracting entities in terms of this Directive, but they are fulfilling their function as (ordinary) employers.

In view of these opposing positions, the Commission introduced an action at the ECJ against Germany in June 2008. Since occupational pensions are often ruled by collective agreements – especially in Northern Europe or in the Netherlands – the Swedish and Danish governments joined the case as interveners in April 2009. Hence, this procedure has a European dimension going beyond the mere local sector pension schemes in Germany. Apart from the juridical details of this case, the basic problem of this case lies in finding an answer to the question, whether the "Europe of liberalization" is considered to be more important than "Social Europe". Considering the average duration of infringement procedures in the past year, the ECJ will probably decide in 2010.

Institutional liability (E 5/2007 ex CP 224/2002-AKA)

The core problem of this case was the question if there were an institutional unwritten liability for supplementary pension schemes of the public sector. Contrary to other Member States, German law recognises the legal institution of institutional liability (*Anstaltslast*). This is a sort of contingent liability of the State in case of need, given that the authority responsible for a public-law institution is required to secure the economic basis of the institution and to ensure that it remains operational. According to the case law of the highest German courts, a legal basis is required for the state guarantee, ordering institutional liability. In the legal framework of supplementary pension institutions (legal texts creating such institutions, articles of association), this type of institutional liability or guarantor liability was not set forth, and is still not provided for today.

In spite of this legal background, the Commission initially considered that for institutional liability to exist, it was not necessary that it be normalised in legislation, but could exist as an unwritten legal principle. The Commission considered that unwritten institutional liability of this type amounted to unlawful state aid to supplementary pension institutions unlawful state aid as understood by Art. 87 of the EU Treaty.

The German government had a different point of view. With respect to previous ECJ jurisprudence, supplementary pension institutions of the public sector are not undertakings as understood in Art. 87 of the EU Treaty. They are not operating as competitors on the private insurance market. They act only within the strict and normalised framework of a closed system, governed by a collective agreement. The legal texts of supplementary pension institutions do not contain a legal regulation with respect to institutional liability. According to the German jurisdiction, no institutional liability therefore exists. This interpretation cannot be overridden by European law.

In view of these arguments, the procedure was officially closed May 2009 in line with the view of the German government according to which there is no unwritten institutional liability.

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ANNEX

EAPSPI's working groups and its permanent members

EAPSPI's working groups are treating all issues related to pensions. They are therefore of paramount importance for the work and information exchange within the association. EAPSPI has established a Legal Expert Commission (LEC) with the main focus on legal affairs and a working group on Portability that analyses the feasibility of cross-border transfers of supplementary pension rights. Two further working groups deal with the issues of Taxation and of Asset management.

The working groups are open to all EAPSPI members and observers. The working groups usually meet twice a year and discuss the occurring developments both within their countries and at international and at EU level as well as the impact for their pension institutions. But their work is not limited to a mere information exchange. If necessary, the working groups draft position papers especially on European issues that concern all EAPSPI members. Thus, EAPSPI is able to formulate a common position of the public sector pension institutions towards the European institutions, but also towards national authorities and other entities.

The Legal Expert Commission (LEC)

The Legal Expert Commission (LEC) studies the legal impact of pension related documents issued by European and other institutions, e.g. World Bank, OECD and other (inter)national think-tanks, on EAPSPI's members. When appropriate, the LEC prepares position papers on certain topics with an overall interest for EAPSPI's members. The LEC may also cooperate with other working groups in setting up position papers to be sent to the European institutions (Commission, Parliament) and to other stakeholders at national and EU level.

In 2009, the LEC was composed of the following permanent members (alphabetic order):

- Marie-Paule Copin (SdPSP, Belgium)
- Vasco Costa (CGA, Portugal)
- Erwin de Buyser (SdPSP, Belgium)
- Aitor Emaldi (Elkarkidetza, Basque Country)
- Sonia Geilert (Valida Pension, Austria)
- Hagen Hügelschäffer (EAPSPI)
- Eva Kiwit (AKA, Germany)
- Léon Janssen (APG, The Netherlands – chairman)
- Anne Perälehto-Virkkala (KEVA, Finland)
- Tim Pullman (CDC, France)

- Cyril Savelkoul (APG, The Netherlands)
- Wolfgang Schulz-Weidner (ESIP)
- Björn Selander (KPA, Sweden)
- Trond Tørstad (KLP, Norway)
- Werner Zarbach (VBV, Austria)

The Portability working group

The mission of the Portability working group is to analyse the feasibility of cross-border transfers of supplementary pension rights and to elaborate solutions helping the European Commission, but also other interested institutions and stakeholders in this field, to foster the transferability and thus the free movement of workers within Europe. Accordingly, the Portability working group consists of representatives of only supplementary pension schemes.

In order to achieve these aims, the Portability working group first analysed the existing legal situation in various European countries as far as transferability is concerned. In a next step, basic principles that are valid both for pay-as-you-go and for funded supplementary pension schemes are to be set up. At a further stage, the working group studies the possibilities how to establish practical solutions for transferability between different countries.

Members of the Portability working group are:

- Bjørn Hamre (KLP, Norway)
- Georg von Hinüber (AKA, Germany)
- Hein Leenders (APG, The Netherlands)
- Allan Paldanius (KEVA, Finland)
- Johan Sjöström (KPA, Sweden)
- Jari Sokka (KEVA, Finland)
- Klaus Stürmer (AKA, Germany – chairman)
- Claudia Wegner-Wahnschaffe (VBL, Germany)

The Taxation working group

This group observes developments concerning the European and national tax legislation as well as the jurisdiction of the European Court of Justice (ECJ) in the field of taxation and analyses the impact of these evolutions on EAPSPI's institutions. The working group considers how taxation policies affect pension schemes for public employees. Taxation in the wider sense encompasses not only tax relief, but also, for example, any limits on contributions and accrual, the opportunity to commute pension for lump sums and the flexibility to "wind down" towards retirement.

This working group is composed of the following members:

- Leo Bessems (APG, The Netherlands – chairman)
- Ian Clapperton (SPPA, Scotland)
- Aitor Emaldi (Elkarkidetza, Basque Country)
- Cecilia Froste (KPA, Sweden)
- Joep Heijmans (APG, The Netherlands)
- Hagen Hügelschäffer (EAPSPI)
- Johan Janssens (SdPSP, Belgium)
- Susanne Olsson (SPV, Sweden)
- Johan Sjöström (KPA, Sweden)

The Asset Management working group

This working group is a forum of experts for an in-depth exchange of best practise in order to help members to compare their asset management activities and to learn about the challenges and solutions for other institutions. The initiative was based on a proposal of the Board of Directors at the beginning of 2008, after the subprime crisis burst but some time before the financial crisis worsened. The scope of the working group's activities is not restricted to the sole issue of assets even if the name of this working group might lead to this conclusion. Together with the LEC, the discussion about new solvency and supervisory rules will also have to be observed and analysed thoroughly by this working group.

The following members belong to this most recent working group of EAPSPI:

- José Carlos Garay (Elkarkidetza, Basque Country)
- Sofia Hagman (KPA, Sweden)
- Dr. Volker Heinke (AKA, Germany)
- Bjørn Hamre (KLP, Norway)
- Hagen Hügelschäffer (EAPSPI)
- Ton Leukel (APG, The Netherlands)
- Pierre Leygue (CDC, France)
- Dr. Jean Pfitzmann (ASIP, Switzerland)
- Tim Pullman (CDC, France – chairman)
- Björn Selander (KPA, Sweden)

About EAPSPI

EAPSPI is an association of 24 public sector pension schemes from 16 European countries that are responsible for more than 28 million active members and pensioners in the public sector. The connecting factor of EAPSPI's members is therefore the public sector in Europe: they cover either the basic pension schemes for civil servants or the supplementary schemes for public employees.

EAPSPI's main purpose is to enable its members to improve the mutual knowledge of their institutions and that of the social systems of their respective countries. EAPSPI actively takes part in the construction of a social Europe. EAPSPI's members analyse ways and means of improving services offered to their clients (pensioners, active members and employers) by learning best practices from other institutions and by analysing the impact of EU law for national pension schemes. To achieve this purpose, EAPSPI promotes exchanges of expertise and information through working groups, conferences, seminars, information letters and direct contacts between members

The role of EAPSPI is not limited to a mere information exchange. The importance of EU law in the field of pensions is steadily increasing. Therefore, EAPSPI also offers a common platform for the pension institutions of the public sector towards the European institutions, such as the Commission, the Parliament and other stakeholders at EU level. However, EAPSPI is not a pressure group. EAPSPI merely aims to position itself as a pension expert in order to demonstrate the effects especially of new legislative projects. Hence, EAPSPI develops relations and interacts with European institutions and other international organisations.

EAPSPI

Pensions for the Public Sector

European Association of Public
Sector Pension Institutions

Association Européene
des institutions de retraite
du secteur public

Europäischer Verband
der Versorgungseinrichtungen
des öffentlichen Dienstes

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