TOWERS WATSON

Mark Dowsey
Consultant

Watson House
London Road
Reigate
Surrey RH2 9PQ
UK

T +44 1737 241144
D 01737 274535
F +44 1737 241496
Mark.Dowsey@towerswatson.com

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European Commission
Directorate-General for Employment, Social Affairs &
Equal Opportunities
Green Paper on Pensions consultation
Unit E4
Rue Joseph II
Office J-27 1/216
B - 1040 Brussels

Dear Sirs

GREEN PAPER towards adequate, sustainable and safe European pension systems

We are pleased to provide our views on the questions raised in the Green Paper. Towers Watson is a global professional services company with operations in many European countries. From these various operations, we provide services to many of the managers and sponsors of the largest pension funds in Europe.

1 **How can the EU support Member States' efforts to strengthen the adequacy of pension systems? Should the EU seek to define better what an adequate retirement income may entail?**

With the range in pension systems across the European Economic Area and, in particular, the variance in, and importance of, first, second and third pillar provision, we believe that this should be left to individual Member States. We note that the Commission acknowledges this point in the introduction in section 1 of the Green Paper. However, we see a valuable role in the Commission collating information across all three pillars and making this available to Member States. Access to this information will assist individual Member States when reviewing domestic policy. In particular, this will help Member States determine the adequacy of their first pillar provision benchmarked against measures of relative poverty. The position is more complex in relation to second and third pillar provision. In the case of the former, provision is a mix of the relevant State's tax treatment/incentive of such provision, an employer's total remuneration policy (and hence competitiveness) and agreements between the social partners. In the case of the latter, this is largely a cultural and tax incentivised issue. Given the diversity in form and method of provision, we even doubt whether there are many aspects on which 'advice' from the Commission would be helpful.

2 **Is the existing pension framework at the EU level sufficient to ensure sustainable public finances?**

From an actuarial point of view we note that guaranteed fixed pensions either nominal or, especially, real are not sustainable. Increasing life expectancy and movements in the economy and capital markets are such that guarantees are extremely difficult, if not impossible, to provide. We therefore should allow for dynamic pensions - pensions that can grow or shrink with market and mortality experience.

3 **How can higher effective retirement ages best be achieved and how could increases in pensionable ages contribute? Should automatic adjustment mechanisms related to demographic changes be introduced in pension systems in order to balance the time spent in work and in retirement? What role could the EU level play in this regard?**

A rebalancing of the time spent in retirement and that spent in work is desirable. However, this is not achieved through simply increasing the retirement age; there need to be political and practical measures to encourage prolonged economic activity. Otherwise, all that is achieved is a shift from one form of social benefit (pension) to another (unemployment/income support). Specific policies are most appropriately kept within the remit of individual Member States.

However, Member States do not have the luxury of being able to wait until the culture of early economic inactivity is overcome before adjusting pension age. Adjustments to first pillar retirement ages are likely to be part of the process of culture change. Moreover given the highly political sensitivity of extending State pension age and the necessarily long 'lead in' time, action is needed now. The EC's role should be one of encouraging and supporting Member States and depoliticising this issue. This can be facilitated through education of EC citizens, highlighting that inaction is simply not an option.

4 **How can the implementation of the Europe 2020 strategy be used to promote longer employment, its benefits to business and to address age discrimination in the labour market?**

The Commission should encourage Member States to remove legal, fiscal and social barriers to longer working. Employers and employees together have the task of creating a lifestyle integrated with work that citizens will not wish to retire from. To assist this, there should be an analysis of what drives 'engagement' between the social partners. Flexible working practice should be encouraged to enable citizens to adjust the balance of their working, caring, learning and leisure activities as their circumstances and needs change.

We append a further note, which explains the threat and opportunity arising from the coming of age of the 'baby boomer' generation in a whimsical narrative style – see appendix.

5 **In which way should the IORP Directive be amended to improve the conditions for cross-border activity?**

We believe that there are three areas that need to be looked at.

The first, and most important, is to have a clear statement as to what constitutes cross-border activity. As Member States have all implemented the provisions of the Directive, we acknowledge that any change in national interpretation would present challenges. For example, it could result in a pension fund or 'scheme' that is currently considered by the home supervisors to be a 'cross-border arrangement' being considered 'domestic-only'. The reverse would have more onerous and significant consequences as a more stringent regime applies to arrangements carrying out cross-border activity. In the light of this last point, any proposal to impose a universal 'definition' would need to allow a lengthy transition, so as to give national legislators sufficient time for IORPs to make any appropriate changes.

The second is to offer more guidance on what is intended by 'social and labour law' relating to retirement provision. At the moment, references[1] in the Directive are vague – providing non-exhaustive examples. It would be helpful if the Directive could identify core social and labour law provisions that might be appropriate for a 'host' Member State to consider designating, with a requirement that any additional designated laws must be notified to EIOPA and an explanation offered as to why they are necessary.

[1] Such as article 20(1) "including compulsory membership and the outcomes of collective bargaining agreements" and recital 37 which refers to "for example the definition and payment of retirement benefits and the conditions for transferability of pension rights".

The third would be to seek greater harmonisation of disclosure[1] specifics – ie covering what has to be provided, to whom and when. Broadly speaking, most Member States require the same information to be provided at the same junctures – for example on joining, annually and at or before a benefit event. At this level harmonisation might not be too difficult. However, harmonisation of specifics, such as, for example, the 'timing' of disclosures and any assumptions used for 'projections' is likely to be a greater challenge.

6 **What should be the scope of schemes covered by EU level action on removing obstacles for mobility?**

From a principled perspective, any obstacles to mobility are undesirable irrespective of the nature of the pension fund/scheme. Therefore, all pension arrangements should be included within any proposed action. However, the Commission must note that practical issues in some Member States make this impossible under current legislative requirements. By way of an example, in Germany a transfer of book reserved liabilities requires the consent of the Pensions-Sicherungs-Verein VVaG – which will not normally be given.

7 **Should the EU look again at the issue of transfers or would minimum standards on acquisition and preservation, plus an EU level tracking service for all types of pension rights, be a better solution?**

From a social perspective, a voluntary, fair, simple and consistently applied transfer regime is the best solution. We recognise, however, the challenge of obtaining agreement on this point from all Member States and believe that minimum standards on acquisition and preservation with the additional facility of a Member State-determined pension tracking system would be a considerable step forward and a goal worth pursuing.

8 **Does current EU legislation need reviewing to ensure a consistent regulation and supervision of funded (ie, backed by a fund of assets) pension schemes and products? If so, which elements?**

Whilst a review appears, at first glance, to be a good policy this is unnecessary in the short term as we expect greater consistency to develop over time, flowing naturally from both the implementation of the updated Budapest Protocol and the development of the additional competencies of EIOPA over those of CEIOPS.

9 **How could European regulation or a code of good practice help Member States achieve a better balance for pension savers and pension providers between risks, security and affordability?**

The question appears to start from the premise that the existing balance is wrong. We think that the Commission should evidence that this is the case before suggesting a change. Although we know that the Commission is well aware, it is worth reiterating that increased security leads to either increased cost or a lower level of benefit, thus directly affecting sustainability and adequacy.

The section in the Green Paper cites that 'minimum return guarantees' can reduce short-term volatility. Whilst such guarantees are required in some Member States, these are often where such DC arrangements currently constitute a minority of provision over the three pillars. Moreover, given the long-term nature of pension fund investment, short-term volatility should be less relevant – but this pre-supposes a gradual transition between funds with different risk/reward characteristics over members/participants working lives. In many countries that have more significant DC provision investment guarantees do not apply. We consider that imposing a minimum investment guarantee could adversely affect behaviour – notably a drive towards low-risk/low-reward investments – and hence lower overall retirement benefits. Perhaps more concerning, given the significant size of DC assets in some countries, this would have scope for influencing markets and further driving down yields. For these reasons we do not consider that it is helpful even to 'encourage' use of such

[1] Article 20(7) automatically applies the host State's requirements (at least as far as members are concerned).

guarantees. That is not to say that they are inappropriate in all circumstances, but any prescription on this should be left to individual Member States.

By contrast, we welcome any move – perhaps through a Code of Good Practice to further encourage the use of 'lifestyle' funds where appropriate across the EU – as an option for active selection by members/participants or, indeed, a suitable 'default' investment approach for individuals who do not exercise any choice.

While it is appropriate to consider whether or not annuitisation should be mandatory, we believe that in line with the principle of subsidiarity this must be addressed at Member State level given the wide variety in pension regimes. In particular, we are concerned that annuitisation introduces significant conversion risk. Our inclination is against mandatory annuitisation. Again, however, we believe that it would be helpful for the Commission to collate data on Members States' positions, making this available to all Member States.

10. **What should an equivalent solvency regime for pension funds look like?**

As the Commission acknowledges in the Green Paper, national pension systems and protection mechanisms vary greatly and unlike insurance-based consumer financial products, these are often interwoven with social security systems and social partnership agreements. Trying to impose a uniform regime across Europe is, therefore, generally undesirable. However, the IORP Directive has already introduced a minimum funding standard and we acknowledge that the impending demise of Solvency I prompts review of an appropriate approach given the cross-reference to that regime within the IORP Directive (albeit the cross-reference applies only to 'regulatory own funds' pension funds). Against this backdrop, we believe it is possible to consider national funding regimes and to then take account of discrete aspects of each country's social/member protection mechanisms. For example, this could factor in the employer covenant, subordinated loans, conditional indexation or benefit adjustment powers as appropriate. The totality of each country's mechanisms could then be benchmarked against a Solvency II-derived standard.

A variation on this might be to apply the Solvency-II derived standard to a given level of benefit determined at national level. For example, in those jurisdictions where accrued benefits can be reduced in a funding crisis, this might be, say, 85% of the headline pension promised. In those countries (eg Germany and UK) where a standalone minimum guarantee system is in place, it might be appropriate to apply the Solvency-II derived funding level only to benefit provision above the level provided by the guarantee system.

It would be helpful if employers and employees have a clear understanding as to the 'strength' of the pension promise. In some countries the level of certainty can vary from plan to plan – for example, one plan might operate on a 97.5% certainty of no shortfall within a year, whereas another might have, say, an 80% certainty. If the level of certainty is enshrined within the pension agreement, it would be possible to supervise schemes on the 99.5% certainty level of Solvency II, but applied to the 97.5% or 80% used in these examples. Where such variance is possible, the Commission could promote its disclosure possibly by incorporation of the need for transparency to form part of the relevant Member State's social and labour law.

11. **Should the protection provided by EU legislation in the case of the insolvency of pension sponsoring employers be enhanced and, if so, how?**

The Green Paper asks whether there is a need to promote 'pension benefit guarantee systems'. If the presence of such arrangements can be taken into account in any 'harmonised' solvency regime, then Member States may be encouraged to establish similar systems, but once more, this is a matter for national Governments. In passing, we fail to see how such an arrangement could be applied sensibly to DC plans other than in the limited circumstances of, for example, loss through fraud. Certainly any attempt to create a 'lifeboat' fund to protect against market falls would seem to present unacceptable moral hazard risks. Lifestyling defaults would seem a preferable option for managing market movement risks – although it must be accepted that those risks cannot be completely eliminated at an acceptable cost.

12. **Is there a case for modernising the current minimum information disclosure requirements for pension products (eg, in terms of comparability, standardisation and clarity)?**

See our response to question 5. Generally, an additional layer of disclosure requirements is undesirable and might be ineffective as 'more information' does not necessarily result in improved understanding on the part of a member (participant or beneficiary). A gradual harmonisation of existing provisions in those areas where such harmonisation is possible is attractive and could perhaps develop – through encouragement, rather than legislation - out of work carried out by CEIOPS/EIOPA.

As an exception, however, we think the Commission should consider encouraging Member States to disclose not only projected benefits but also an indication of the types of risks affecting whether schemes will be able to deliver these benefits. This might help emphasise that what is at issue is a benefit expectation rather than a promise. Members/participants might also usefully be informed of any intergenerational cross-subsidy (solidarity).

13. **Should the EU develop a common approach for default options about participation and investment choice?**

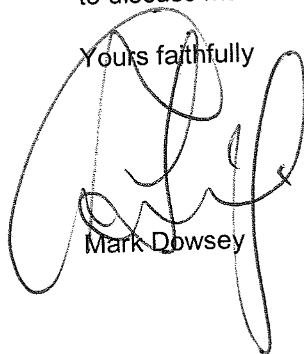
Imposition of EU-wide provisions seems unnecessary. However, individual Member States can learn from one another's experiences and we would encourage the Commission in its role of collating information from national governments as to (i) their actions in – for example – implementing automatic enrolment mechanisms or operating default lifecycle funds and (ii) the emerging effect on retirement outcomes.

14. **Should the policy co-ordination framework at EU level be strengthened? If so, which elements need strengthening in order to improve the design and implementation of pension policy through an integrated approach? Would the creation of a platform for monitoring all aspects of pension policy in an integrated manner be part of the way forward?**

A single, accessible record of Member States' pension policies would be useful. In this regard, it is not always clear where material is to be found on 'europa.eu'.

We hope that the Commission will find the foregoing helpful. If there are any aspects about which you would like further information, then please let us know. Additionally, if the Commission considers it helpful to discuss matters further, we would be very pleased to meet with officials.

Yours faithfully



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Appendix

Europe 2020 - two scenarios

The year is 2020

The youngest baby boomers are midway through their sixties and starting to claim their Social Security benefits. And none too soon, since the coffers are nearly empty. As many boomers say with only a touch of irony, at least we got ours.

The fittest boomers still boast that eighty is the new sixty, but the rest of Europe has gotten tired of footing the bill for their lengthy retirement. After a seemingly endless run, Europe is ready for the baby boom generation to finally get off the stage.

With more than one in four Europeans over sixty in this future society, generational conflicts abound. Walkers outnumber joggers; nursing homes proliferate while schools close. The millennial generation, now mostly in their thirties and forties, have taken "extreme working" to new heights, putting in extra shifts to support not only truly needy children and the elderly, but also a vast cohort of "greedy geezers" spending one-third of their lives on subsidized vacation.

Europe owes a debt to the boomers - in the form of an intractable deficit pushing the countries ever closer to default. Spending on boomers' pensions and health care has replaced nearly all investments in the nation's future. Not only children, but the environment and the economy are suffering from these lost opportunities. Europe, like its swelling population of pensioners, is visibly and painfully well past its prime.

Now imagine a different scenario

It's still 2020. The boomers are indeed starting to leave the stage. But their journey has been a rousing one and the legacy they leave is far different.

There is a palpable sense of progress. Longevity, demography, human development, generational experience, fiscal imperatives, labour market dictates, and the particular historical moment combined to lead boomers to contribute longer and to use their education and experience in areas with jobs to offer, deeper meaning to confer, and broader social purposes to fulfill.

Faced with the practical necessity of extended working lives, boomers have made it a virtue, getting busy on their next chapters, second acts, or Careers v2.0. Some of the ills that seemed intractable at the beginning of the twenty-first century are fading, and others that appeared only to be worsening have made a 180° turn—all thanks to boomer labour power, now known as the "experience dividend".

Now, nearly everyone looks forward to a second career. The oldest members of the millennial generation, entering their fifties, are getting ready for their own second acts, and younger people clamor for "purpose-driven jobs" in the same way earlier generations embraced early retirement. The goal now is to be able to stop climbing the ladder and start making a difference, to trade money for meaning, to have the latitude to work on things that matter most.

What are the effects of the European 2020 Strategy?

- **Longer employment**

  The boomers now function as the backbone of education, health care, non-profit organisations, the government and other sectors essential to national well-being. This group is serving as the glue of society in much the way women carried a whole set of caring professions in the first half of the twentieth century. And the windfall has not just been in numbers and experience. Second-stage social entrepreneurship and innovation is being spearheaded by individuals bringing the accumulated skills from the first half of working life to the higher goals of their second acts.

- **Benefits to Business**

Whole new industries and institutions service boomers on the path to new purpose. Meanwhile, financial services firms and other businesses have found considerable profit in helping individuals plan for their second phase of work and contribution. Rather than saving in midlife to finance outright retirement in their late fifties or early to mid-sixties, with no income from work, people save in their middle years to buy an extra measure of freedom in their second half of work - for a time when they can swap income for impact.

- Addressing Age Discrimination

  Spurred by enlightened public policy, encore careers provide a second chance at upward mobility for individuals from the less affluent end of the socioeconomic spectrum. New skills and increased education open new doors, reflecting the emerging reality that this chapter of work is not only about using your experience but also about acquiring new know-how. The experience economy" takes on an entirely new meaning in the process.