Response to the Consultative Document of the European Commission services

Consultation 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

European Commission, Internal Market and Services DG
Financial Institutions, Insurance and pensions
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AEGON welcomes the opportunity to take part in this consultation.

AEGON has pension businesses around the world. The company has major operations in the European Union and North America. In recent years, AEGON has also expanded its activities in Asia.

In the European Union, AEGON provides both occupational and personal pensions, either directly to customers or indirectly via their employers. AEGON provides pensions and pension-related services and relies on both the Life Insurance and IORP Directives. The company is also active in asset management.

As an international provider of life insurance, pensions and investment products, our mission is to help secure the long-term financial futures of our customers across the European Union and around the world.

We believe this consultation will improve common understanding of the diverse national pension systems in the European Union and will prove an important step towards increasing long-term financial security for millions of its citizens.

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EXECUTIVE SUMMARY

1. **Need to take into account the wider pensions landscape**

A full response to the issues raised by Commission consultation needs to:
- make clear the interaction - not just the difference - between the social and prudential aspects of pensions;
- assess the IORP Directive as a financial services law in the context of a wider reform programme towards a more coherent and modern system of EU financial services rules;
- look beyond the narrow focus of this consultation (Article 17 and cross-border IORPs).

2. **Need for a “common language” in pensions**

There is a need for a “common language” on pensions to allow meaningful comparison between different pension providers, types and systems whether in a domestic or cross-border context. This common language must be economic, risk-based in approach, relying on market consistent valuation. It will improve transparency and rational choice, allowing:
- citizens to plan their pensions future by being able to compare different providers and pensions on the basis of identifiable similarities and differences.
- law and policy makers to make informed choices between different pensions systems.

3. **Need for a modern solvency framework for IORPs**

Solvency I is outdated. Solvency II for life insurers embodies a modern economic, risk-based approach, relying on market-consistent valuation. This approach should also be applied to IORPs. Such an approach will take into account any real differences between IORPs and life insurers and between the different kinds of IORPs.

4. **Need to keep in mind a single market goal**

The review of the IORP Directive also needs to aim at ensuring that the potential of the single market is both realized and open to third country involvement.

5. **Next steps**

- The concept of a common language embodying an economic, risk-based approach needs to be taken forward now.
- A full review of the IORP Directive should be a priority for the new Commission in 2010.
GLOSSARY

Note: all references to "Articles" and "Recitals" are to the IORP Directive unless otherwise indicated.

**Article 17 IORP**  An IORP that itself bears the biometric and/or investment risk under a pension scheme (Article 17(1)).

**CEIOPS**  Committee of European Insurance and Occupational Pensions Supervisors.

**CEIOPS Funding Survey**  *Survey on fully funded, technical provisions and security mechanisms in the European occupational pension sector, CEIOPS-OPSSC-01/08 Final, 31 March 2008.*

**CEIOPS IORP Report**  *Initial review of key aspects of the implementation of the IORP directive, CEIOPS-OP-03-08, 31 March 2008.*

**CEIOPS Key Issues Paper**  *Key issues on solvency for the European occupational pension sector, CEIOPS-OPSSC-11/08, 31 May 2008.*

**Commission Consultation**  European Commission, DG MARKT, *Consultative Document - Consultation 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, Reference Ares (08) 14767, 3 September 2008.*

**cross-border IORP**  Any IORP carrying out “cross-border activity”. Arises where an IORP and a sponsor (employer) are not located in the same Member State (Article 20(1)-(2)).

**IORP**  Institution for Occupational Retirement Provision – defined in Article 6(a), IORP Directive (Directive 2003/41/EC)). IORPs provide funded occupational schemes. Some entities that satisfy the definition of an IORP may be excluded from the scope of the Directive because they fall under other EU rules (see Article 2(2)).

**non-Article 17 IORP**  Any IORP not falling under Article 17 IORP Directive. Includes not only providers of pure defined contribution (DC) arrangements but also, e.g. defined benefit (DB) schemes where the IORP does not bear the risk.
PART 1 - GENERAL PRELIMINARY REMARKS

1. Taking into account the wider pensions context

A complete response to the issues raised by the Commission consultation requires the wider pensions’ context to be taken into account.

1.1. Understanding interaction between 'social' and 'market' aspects of pensions

Since pensions have a social dimension, assessments of the suitability of particular financial services rules must also take this dimension into account. Pension delivery systems across EU Member States differ in how 'social' or 'market'-orientated they are. At one end of the spectrum, the redistributive 'social' principle of solidarity completely replaces the market mechanism. At the other end, 'market' principles of competition and individual responsibility apply. But in between, elements of both are simultaneously present in varying degrees. This is particularly true of workplace pensions. Across the EU, national variations on the ‘three pillar’ theme mix and match ‘social’ and ‘market’ elements at will.

The frontier between the 'social' and 'market' aspects of pensions is important as responsibility for social policy is still mainly national. Each Member State can choose the pension system it wants, define what are to be appropriate pension benefits under its system, specify the role of social partners and forms and levels of solidarity (if any) in its system. It also seems free to set levels of security to be provided as well organize its own security mechanisms (if this is correct, its implications for internal market regulation need digesting). The closer pension provision moves towards the market, the more that (potential) scheme members access pensions as consumers rather than as citizens or workers. At this end of the spectrum Member States nonetheless enjoy significant powers, even though the market dimension means that it is much more 'Europeanized'.

Social policy decisions about pensions (e.g. whether schemes should be defined benefit or defined contribution, what degree of solidarity, if any, should be incorporated etc.) have an impact on the financial services rules applicable to pension providers. Analogous

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1 The terms 'social' and 'market' are used here as short-hand for principles that find a general rather than a precise correspondence to groupings of legal competences in the EC Treaty. There is no general definition of either term in the EC Treaty or in the case law of the European Court of Justice. The concept of 'social' is best understood by reference to a range of 'social' provisions including those with a workplace reference. The concept of 'solidarity' has been developed primarily in the context of the competition rules to demarcate the limits of the market mechanism. The concept of a 'market' is best understood in terms of 'economic activity' for which there are definitions under case law relating to the basic economic freedoms and to the competition rules of the EC Treaty.

2 The three pillar system in pensions is a broad-brush description of the three types of pension system that a Member State may use. The first often involves state-based pay-as-you-go systems. However, funded elements are also present in some first pillar systems. Second pillar systems may be workplace or mandatory or both. Third pillar systems are often individual or voluntary. Although individual Member States may identify three (or more) pillars in their systems, there is no unified EU-level three-pillar model. Member States use different EU laws to govern the operation of their three pillars. For example, as regards the ‘second pillar’ the mainstay of Danish workplace provision is based on the Life Insurance Directive. In the UK it is the IORP Directive.

3 Via the so-called 'general good' exception. See Commission Interpretative Communication - Freedom to provide services and the general good in the insurance sector (2000/C 43/03), OJ C 43/5, 16.02.2000.
considerations apply in the other direction. So EU pension reform requires not only that the frontier between 'social' and 'market' domains is clarified, but also the way in which these two domains interact. This is a complex but necessary task.

1.2. Taking into account increasing coherence across EU financial services rules
The IORP Directive is not an island disconnected from other EU financial services rules. While EU financial services rules still show considerable regulatory fragmentation, there is nonetheless a drive in this area towards greater coherence. The single market model for financial services is increasingly moving away from a traditional, institutional and legalistic approach towards an increasingly integrated and more economic approach to regulation and supervision.

In the context of pensions, this more modern approach to regulation means considering both the entire range of financial services providers and the specific role they have in the pension production and delivery process.\(^4\) Solvency II for insurers is just one example of the trend towards greater coherence based around an economic risk-based approach. Under the proposed Solvency II Directive, different types of insurance companies previously dealt with under separate laws would be brought together under one principle-based framework.

Assessments of the IORP Directive need to take this wider trend towards greater coherence between financial services regulatory frameworks into account.

1.3. The risks of an excessively narrow scope
The Commission consultation focuses on two subclasses of IORPs, Article 17 IORPs and cross-border IORPs. Should a solvency framework be developed exclusively for these IORPs without consideration of other IORPs and pension providers? Two considerations suggest not:

- From a formal legal perspective, unless the two categories of IORP can be clearly distinguished from other types of IORP, it would be sensible also to consider neighbouring types of IORPs in the consultation. There are grounds to doubt the legal clarity of these categories.\(^5\)

\(^4\) This may be as a direct provider of pensions or as a service provider to pension providers, so different provider types may complement each other and not just compete with one another. It may also be that we need to distinguish more clearly between roles during the 'accumulation' and 'decumulation' phases. It is also clear that the same EU rules are used differently in different Member States because of differences in national pensions architectures. We need a way to look through formally identified institutions and structures, whether EU or national, to consider purposes and functioning.

\(^5\) It is not obvious that they can be easily distinguished from other types of IORP:

- The test for identifying Article 17 IORPs is based on the presence of a single party who exclusively bears risk. What happens where risk is shared? Identification of Article 17 IORPs may also be affected by differences in views on how to classify DB and DC schemes. Note CEIOPS' comments about variations in meaning of DB and DC across the EU (CEIOPS Funding Survey, page 11).

- It is doubtful that cross-border IORPs can be unequivocally identified given current uncertainties about when an IORP is carrying on cross-border activity. CEIOPS IORP Report suggests that Member States do not agree amongst themselves as to which entities are cross-border IORPs. See its call for "urgent clarification" CEIOPS IORP Report, pages 15, 58-60 on the concept of cross-border activity in the IORP Directive.
- Even if they are legally clear, does legislating on the basis of these categories make policy sense? In particular, if apart from the question of available security mechanisms, non-Article 17 IORPs and Article 17 IORPs otherwise face similar prudential risks due to the nature of the scheme and pension commitment, why should they be regarded as fundamentally different from one another? In any event, one should consider asking whether the conceptual framework for solvency issues developed for Article 17 IORPs should not also be capable of covering other IORPs in analogous situations. The very nature of a common language (see Point 2) is to enable different types of pension provider to be compared, this means trying to link up different categories of IORP rather than legislating in terms of isolated 'carve outs'.

2. The need for a "common language" on pensions

Any assessment requires comparison, and this presupposes a common system of categorizing and common standards.

In the context of IORPs, CEIOPS notes that although it may be possible for different types of security mechanism to deliver similar levels of security it is also quite clear that we are unable to know if this is the case because, without a common language for pensions, we are unable to make meaningful comparisons between the different systems and their security mechanisms.

This grammar of this common language must embody an economic, risk-based approach so it can support economically justifiable analytic distinctions between the varieties of IORPs and other pension providers across the EU, taking into account the type of pension provided and security mechanisms available. The economic basis must be founded upon a market consistent approach to valuation of an IORP's assets and liabilities. It must also enable transparency towards the supervisors and also, ultimately, towards the (future) pensioner. (See Question 3, Commission consultation, 'Overarching principles')

In view of the remarks in Section 1, the common language should also:

- be capable of taking an integrated approach to both 'social' and 'market' domains of pensions (in which national and a European-level aspects can be distinguished) and in which the interaction, not just the differences, between these two domains is better understood;

- embody a common economic logic and methodology compatible with the wider EU financial services landscape. This enables 'level playing fields' issues, regulatory

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6 DB, those DC schemes involving performance and/or 'contributions back' guarantees as well as 'hybrid' schemes involving DB and DC components. See CEIOPS Funding Survey, Glossary of Terms, Annex 3, page 46.

7 CEIOPS Funding Survey, page 7. The Commission used this survey in preparing the consultation.

8 CEIOPS Funding Survey, pages 7 and 41. See also CEIOPS Key Issues Paper, page 9.
modernization and discussions of the coherence of existing rules (gaps and overlaps) to be addressed;

- be applicable to other types of IORPs and other pension providers where similar risks are covered, including IORPs providing schemes covering biometric and investment risk not underwritten by the IORP.\(^9\)

The ability to make real comparisons between pension provision mechanisms is not just relevant to cross-border arrangements. It is also needed in domestic systems as it will enable citizens to make rational choices between types of providers and pensions. Furthermore, such a common language would reinforce wider EU initiatives under the Open Method of Coordination as extended to pensions to improve the possibility to compare different pension systems by creating a coordinated trans-national perspective using national reports based on common indicators.\(^10\)

3. **A modern solvency framework or "applying Solvency II to IORPs"?**

IORPs need a modern solvency framework. This issue is separate from questions about possible effects on IORPs due to Article 17 and the new Solvency II regime for insurers.

- Concerns about the effectiveness of the Solvency I regime for insurance motivated the shift towards an economic risk-based approach. The Solvency II project embodies this new approach for life insurance companies. If Solvency I is inherently outdated, there should also be an equivalent shift towards a more modern, economic risk-based approach for IORPs. Furthermore, the fact that the IORP Directive ties its solvency requirements to those applicable to life insurance companies was not an accident: the European legislator intended the same rules to apply in the provision of similar products.\(^11\) Therefore, the shift to Solvency II and the economic overlap between IORPs and life insurers implies a strong presumption that any new regime for IORPs should also be economic, risk-based in approach.

It would enable IORPs to understand risk and manage it more efficiently. Increased transparency will enable supervisors to do their job better and,

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\(^9\) For example, book reserve systems, funded systems classed as part of the social security system or non-Article 17 IORPs providing schemes in which biometric or investment risk is covered.

\(^10\) Because of the national veto in social policy matters, this method does not rely on binding legal obligations but on comparison and the setting of non-binding policy objectives. The non-binding objectives for pensions to be pursued under the Open Method of Coordination are based around three principles, endorsed by Member States, relating to:

- adequacy of retirement income for pensioners;
- financial sustainability of public and private pension schemes;
- transparency and being able to meet the requirements of modern societies.

First emerging in 2001, these principles were restated and endorsed by Member States on 10 March 2006. The development of common indicators underpinning national reporting exercises are giving gradually giving substance to the common pensions objectives and are first steps towards an overarching policy (rather than legal) framework that ought to be developed further.

\(^11\) Article 17 as read in conjunction with Recital 30. See also Recital 12 concerning issues of competitive distortion in relation to other providers of occupational pensions who fall under different EU rules.
ultimately, provide Europe’s citizens with greater security and an understanding of differences between levels of security for different types of pensions. In this sense, a modern solvency regime is not about creating a list of rules but a methodology - a common language for pension systems - that takes relevant economic differences into account. Only this will allow meaningful cross-system comparison.

- Discussions in terms of whether we should ‘apply the Solvency II Directive’ to IORPs risk generating more heat than light.12 Creating a modern solvency framework for IORPs will not be achieved by inserting parts of the forthcoming Solvency II Directive into the IORP Directive (‘copy and paste’). As the Directives are very different in structure and content, what would emerge would be incoherent.

In any event, developing an economic, risk-based approach for IORPs would involve a broader, holistic approach based on three mutually reinforcing and interacting components: quantitative elements for calculating capital requirements to fulfil pensions commitments (Pillar I), requirements for governance and risk management (Pillar 2) and supervisory reporting and transparency requirements (Pillar 3). Introducing all this into the IORP Directive via Article 17 alone would not be possible.

4. ‘Pension funds are different’ and the need for transparency

Blanket approaches blocking off any solvency review for IORPs on the basis that that “pension funds are different” need to be treated with scepticism. Such claims are often based on real but local specificities.13 If “pension funds are different”, it is also because they are not an homogenous class: pension funds also different from one another other. A modern and economic solvency regime for pensions relying on a common language in the sense described would cater for this diversity.

The common methodology does not automatically imply common rules. But the current situation embodied in the IORP Directive seems sensible: the more a pension product approximates to a product provided by a life insurance company, the presumption must be that the same solvency rules should apply.14

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12 One stream of discussions about “applying Solvency II” to pension funds has really been about the effect of Article 17 after a Solvency II Directive is adopted. Article 17 acts as a ‘dynamic link’ between the Life Insurance Directive (and a Solvency II Directive as its successor) and the IORP Directive. Currently Article 17 applies Articles 27 and 28 of Directive 2002/83/EC (Solvency I) to certain types of IORP. Under a Solvency II Directive in the form proposed by the European Commission, they would be replaced by a range of ‘Level 1’ elements from ‘Pillar I’ of Solvency II for insurers into the IORP regime. This would not introduce an equivalent risk-based, economic regime to IORPs because:
- it is impossible under the current IORP Directive (not a Lamfalussy directive) to adopt ‘Level 2’ technical implementing measures (needed to flesh out ‘Level 1’ principles);
- just focussing on ‘Pillar I’ elements, will omit necessary ‘Pillar II’ and ‘Pillar III’ changes.
Change effected via the Article 17 link is likely to introduce a legal hotchpotch and not a risk-based, economic approach to solvency to IORPs and would also create legal uncertainty.

13 Not all pension funds have governance structures that involve social partners significantly in their activities; not all pension funds have employer backing; not all pension funds have flexible benefit commitments...

14 This is the implication of the Article 17 link as justified by Recital 30. See also Recital 12.
Ultimately Europe's citizens (whether acting as employees, consumers, employers, pension providers, regulators, law or policy makers) also need to understand the significance of differences between different provider-types and pensions. A common language in the sense described for valuation and assessment would enable rational choice enabling trade-offs between security, adequacy and affordability to be understood. If individuals are to bear more and more responsibility for financial planning for their old age such transparency coupled with initiatives to improve financial literacy are essential. But this not only applies to choices about which provider or which pension, it also enables rational choice as between different pension systems.

5. Single market ambitions must not be neglected

The IORP Directive declared itself to represent "a first step on the way to an internal market for occupational retirement provision organised on a European scale". Even within the natural limits on integration in this area imposed by the national character of social protection systems (re-enforced by cultural and linguistic preferences) there is still scope for realizing the potential of the single market. This potential must also involve openness for third country involvement (i.e. beyond the European Economic Area). Many providers, including AEGON, devote considerable thought as to how to single market legislation can be used to provide pensions and life insurance products in the most efficient manner possible, regardless of provider type and whether citizens access their pensions as workers, self-employed or consumers.

6. Next steps

Principles of better regulation require that laws, once they enter into force, are subject to ex-post evaluation to see if they achieve their aims. We do not have to wait for an incident of manifest failure before acting.

Pressure for change is already there. The IORP Directive already contains its own reporting and review deadlines. Even if postponed, they presuppose prior work-streams. In addition, external developments need also to be taken into account such as the recasting of the insurance directives. In 2006, the European Parliament called, as a "matter of urgency", for the IORP Directive to be upgraded so as to include modernized

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15 Recital 6.
17 These relate to:
  - investment rules (Articles 19 and 21 – report deadline was 2007);
  - technical provisions (Article 15 – two-yearly reports deadline for first was 2005);
  - role of depositaries (Articles 19 and 21 – report deadline was 2007).
There is also a requirement to consider extending the optional application of the Directive to other financial services providers (Recital 12) but this has no deadline.
comitology procedures. In 2008, CEIOPS called for "urgent clarification" at European level of aspects of the Directive. The financial crisis also provides an additional element of urgency for reviewing the IORP Directive's outdated solvency regime.

It also seems unlikely that the issues raised by this consultation can be solved just by issuing interpretive guidelines. Work by both the Commission services and CEIOPS means that we are not starting from zero. Therefore, we can set dates not just objectives:

- the concept of a common language embodying an economic, risk-based approach needs to be taken forward now and

- a full review of the IORP Directive should be a priority for the new Commission in 2010.

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18 This is to include the 'regulatory procedure with scrutiny'. See *Statement by the European Parliament, the Council and the Commission concerning the Council - Decision of 17 July 2006 amending Decision 1999/468/EC laying down the procedures for the exercise of implementing powers conferred on the Commission (2006/512/EC), (2006/C 255/01)*, Official Journal, 21.10.2006. In its present form the IORP Directive is not a Lamfalussy directive. It could be converted into one by inserting appropriate comitology clauses and by ensuring a more principled-based approach (economic, risk-based). Such an 'upgrade' would enable many of the technical challenges currently faced to be solved without major legislative upheaval.

PART 2 - AEGON RESPONSES TO INDIVIDUAL COMMISSION QUESTIONS

For the sake of convenience we have identified Commission questions 1 through to 10(e) by inserting them in grey boxes and related Commission comment is included in lighter grey boxes.

A. IORPS SUBJECT TO ARTICLE 17 OF THE IORP DIRECTIVE

This section focuses on IORPs that are subject to Article 17 of the IORP Directive. These IORPs underwrite liabilities to cover against biometric risks, or provide guarantees of a given investment performance or a given level of benefits. They are therefore required to have regulatory own funds, i.e. "additional assets above the technical provisions to serve as a buffer". For these regulatory own funds, Article 17(2) of the IORP Directive refers to the Solvency I regime in the recast Life Directive. As the recast Life Directive will cease to exist after the adoption of Solvency II, the main question for IORPs subject to Article 17 is whether and to what extent the Solvency I regime should be replaced by solvency rules similar or equivalent to the Solvency II rules.

This main question is dealt with by looking first, in general terms, at the objectives and principles of the solvency rules and then, more specifically, at the rules relating to regulatory own funds and funding.

AEGON response to Main Question

All IORPs should be subject to an economic risk-based prudential system such as that embodied in the Solvency II project for insurance companies. Europe does not need to repeat the debate on whether Solvency I is outdated. The IORP Directive should also embody an economic, risk-based approach but real differences between IORPs and life insurance need identifying and taking into account as do differences between IORPs across Europe. The interaction between social and labour law requirements and financial services requirements also needs to be better understood. In order to have a prudential system that respects national diversity in the area of social policy we need, as a first step, a common language for pensions.

1. Objective of solvency rules

1. Solvency rules for IORPs subject to Article 17 should aim at guaranteeing a high degree of security for future pensioners, at a reasonable cost for the sponsoring undertakings, in the context of sustainable pension systems that are decided by the Member States.
Question Do you agree, or do you consider that the overall objective of solvency rules for these IORPs should be different?

AEGON response

For AEGON, even if one were to agree that the elements identified are parts of the overall objective of the solvency rules for IORPs, the relationship between the elements needs to be understood as do the implications that Member States have power to decide the balance between them.

Furthermore, other elements may need to be considered deriving from the legal structure of the EC Treaty, EU financial services policy as well as high-level, albeit non-binding policy commitments that apply to all pension providers:

- As pension systems can have both a ‘social’ and ‘market’ dimension, individual Member State competence relates to more to the ‘social’ rather than to the ‘market’ aspects which are also subject to EU competences. This ‘dual aspect’ of occupational pensions cannot be overlooked and means that the need for cross-border coherence is also to be taken into account (internal market logic) as well as social aspects such as pensions “adequacy” (see third indent below).

- The role and benefits of an increasingly integrated internal market should also be included. IORPs are part of the internal market and serve internal market participants (undertakings, workers and citizens). IORPs, whether or not subject to Article 17, should be able to operate cross-border. (These objectives and principles are therefore relevant both in the context of Section A and Section B of the consultation)

- The objectives and principles should also reflect broader policy initiatives such as the Common Pensions Objectives. These include a need for pensions to be “adequate”, i.e. capable of fulfilling their social purpose such as avoiding poverty.

pensions diversity and the need for common objective standards

Overall, there is probably need to for greater clarification of just how free Member States are under the EC Treaty to determine key aspects pensions systems. If the reference to ‘balancing’ a high degree of pension security against affordability by employers is taken at face value, it appears to imply in a European context that

- different levels of pension security are possible;
- each Member State can decide individually
  - what level of security is appropriate for pensions under its system

20 See comments regarding the Open Method of Coordination in Section 2 in Part 1 above.
how to strike the balance with employer affordability.

This may be a consequence of a Member State's freedom to design its own social protection system but the financial services implications of this freedom need to be understood. If each Member State can set its own product standards, it implies an internal market in occupational pensions based on 27 different sets of product requirement. This means EU-wide supply-side competition for each national market.

If this kind of market is to function, pension providers, supervisors and other stakeholders must be able to determine with relative ease the product requirements, including the relevant degree of security for each host Member State. This goes beyond simply knowing the relevant social and labour law requirements – the financial services implications of those requirements also need to be understood. In a cross-border context, pension providers need to have objectively clear quality standards as one may not assume that one set of prudential rules suitable for delivering e.g. local products will automatically be appropriate for ensuring delivery of other products. Such clear, objective standards will also reduce risks of inappropriate arbitrage (see Question 9(c)) and should facilitate rational choice between products and also providers. The economic, risk-based common language needed for this is missing.21

avoiding an unnecessarily restrictive scope

These issues are of wider relevance than just to Article 17 IORPs.

- Employer-backed schemes provided by IORPs aspire to the same objectives and principles and may face similar biometric and investment risks. The methodology for understanding and assessing these risks for non-Article 17 IORPs should be no different from that for Article 17 IORPs, even if one were to agree that the security mechanism backing the promise is different. Such an approach could improve consistency between the IORP Directive and the pensions provisions of the Employers Insolvency Directive.22

- Similarly a more integrated and holistic approach should also look at other funded workplace pension providers. IORPs excluded from the scope of the Directive by Article 2(2) but satisfying the definition of an IORP in Article 6(a): These include:

  o life insurance companies active in a workplace context (whether operating via Article 4 IORP Directive or otherwise);

21 CEIOPS Funding Survey, page 7. See also General Preliminary Remarks, section 2.
o funded providers declared to fall under statutory social protection systems under Regulation 1408/71.

The presumption should be that these must be subject to the same general principles with differences in other requirements based only on, and proportionate to, objectively identifiable differences.

- More broadly, a shared methodology for assessment and evaluation (including shared measures of security, adequacy and efficiency) should be developed to apply to all pension providers, whether book reserves or pay as you go systems.

### Adequacy of prevailing solvency rules

2. Beneficiaries and sponsors seek to secure occupational pensions that maintain standards of living after retirement. Pension schemes, in particular those that provide life-long income such as annuities, are subject to risks related to future mortality rates, financial returns on assets, future inflation, future participation and contribution rates, which affect the overall solvency position of IORPs subject to Article 17. The CEIOPS survey shows that there are wide differences between Member States in their approach to these and other risks.

2(a) Beneficiary protection and cost to sponsor

**Question a)** Do you believe that prevailing solvency rules for IORPs subject to Article 17 provide adequate protection relative to the objective of safeguarding pension beneficiaries’ claims at reasonable cost for the sponsoring undertakings?

**AEGON response**

Meaningful statements about different levels of protection (whether in relation to a trade-off with sponsors’ costs or not) require an agreed and appropriate measurement of pension security. This economic, risk-based common language is currently lacking at EU level.23

The absence of agreed EU-wide objective criteria as to ‘adequacy of protection’24 means that this question about the adequacy of prevailing standards cannot be answered at a European level. It is not clear whether this question can even be reasonably answered at a national level (see quoted remarks from CEIOPS Funding Survey in footnote 26, response to Question 3(c)).

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23 See above General Preliminary Remarks, section 2, and also CEIOPS Funding Survey, page 7.
24 I.e. security of the commitment - not to be confused with the issue of the adequacy of the pension.
2(b) Identified shortcoming in prevailing rules

**Question b)** Have there been shortcomings or flaws identified in the prevailing solvency rules for IORPs subject to Article 17? If yes, please specify. What could constitute the main challenges lying ahead?

**AEGON response**

The absence of a meaningful common system of risk-sensitive measures at EU level that is applicable to all pension providers, funded or otherwise, makes it difficult to identify shortcomings and flaws. This absence is itself a shortcoming.

2(c) Proactivity and improved risk management

**Question c)** Which solvency rules could be viewed as proactively dealing with different risks and improving risk management techniques?

**AEGON response**

An economic, risk-based approach involves forward-looking analysis and is holistic in approach, relying on quantitative and qualitative elements, such as management processes, transparency and supervisory processes.

2(d) Compulsory versus voluntary membership in pension schemes

**Question d)** To what extent do compulsory versus voluntary membership in pension schemes have a different impact on the overall outcome of solvency rules and in which case(s) are problems likely to arise in the future?

**AEGON response**

Voluntary schemes, in which individual members may enter and leave at will, could feasibly create issues of volatility. Such instability of membership would be lower in a compulsory system. There will be a range of intermediate situations (e.g. where the frequency of individual entry and exit is restricted, e.g. annually, or subject to other conditions). Solvency rules that rest on a principle-based, economic approach would be able to accommodate such differences.
**2(e) Single-employer and multi-employer IORPs**

**Question e)** To what extent do the solvency rules prevailing today in the different Member States need to differ for single-employer or multi-employer IORPs subject to Article 17?

**AEGON response**
In principle, there should be no difference in the solvency principles applied.

### 3. Overarching principles

3. The CEIOPS survey outlines four common overarching principles, as part of emerging best practices underpinning the supervisory framework which may be relevant to this consultation on IORPs subject to Article 17. First, a forward-looking risk-based approach to pension supervision, that weighs the potential risks faced by an IORP, as well as risk mitigants, and tailors the scope and intensity of supervision to this appraisal. Second, the principle of market-consistency in the valuation of an IORP’s assets and liabilities for supervisory purposes. Third, the principle of transparency, which implies that an IORP is open on how its financial position is determined and that reserves (or shortages), as well as prudence embedded in technical provisions and adjustment instruments, are made explicit to the supervisor. Fourth, the principle of proportionality, implying that supervisory requirements are applied in a manner proportionate to the nature, complexity and scale of the IORP’s inherent risks.

**3(a) CEIOPS’ four overarching principles**

**Question a)** Do you agree with these principles and which principles do you consider particularly relevant or not relevant to underpin the supervisory framework for IORPs subject to Article 17?

**AEGON response**
We agree with the first three principles. However, they should apply to all IORPs regardless of whether they are subject to Article 17 or not. We suspect that the fourth principle of proportionality is already inherent in first three principles.

For the principle of proportionality to be workable, there must be a method for identifying, on an objective and quantifiable basis, elements that justify appropriate

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25 With regard to proportionality, Article 5 of the IORP Directive, for example, lays down specific rules for small pension institutions and statutory schemes.
adjustments to the regulatory and supervisory framework. In other words, not only must the principle of proportionality be consistent with principles 1 to 3, but it is probably already implied by them (in particular by the economic, risk-based approach).

3(b) Other overarching principles

**Question b)** Are there any other overarching principles that you consider relevant for IORPs subject to Article 17?

**AEGON response**

There should be a principle of comparability or transparency that encompasses all pension providers and that will enable individuals to compare the security and adequacy of their pension schemes. By its very nature it cannot be restricted to Article 17 IORPs. A holistic approach, based on a common language is a precondition for making rational choices between different pension systems. (See General Preliminary Remarks, section 2.)

3(c) Relevance of size and complexity

**Question c)** Do you see a case for a different supervisory approach for IORPs subject to Article 17 depending on their size or complexity?

**AEGON response**

The principles of an economic, risk-based approach should always be the same. However, application will vary in accordance with complexity. In the presence of simple IORPs the application of the principles will also be simple.

Unless this principle-based, proportional approach is taken, and a more formalistic entity-based approach adopted, there is also a risk of too many institutional 'carve outs'. These will increase fragmentation of an already fragmented system. The IORP Directive already envisages special regimes for small IORPs and also for cross-border providers (more stringent funding rules in certain cases).

3(d) International best practice

**Question d)** To what extent do you consider that the supervisory frameworks existing today for IORPs subject to Article 17 already meet the principles emerging
out of international best practice, as described in the CEIOPS survey?

AEGON response

We think that it is currently hard to make meaningful comparisons between supervisory frameworks other than on a high-level intuitive basis. CEIOPS’ reasoning shows that in the absence of a common language, it would be difficult, if not impossible, to attach a level of overall security across different individual pension systems in a way that made sense.26

It could also be argued that the international principles applicable between the countries of the European Union should enable a greater degree of real comparison rather than compliance with a set of high-level aspirational standards applicable at a more global level.

4. Regulatory own funds and funding rules

4. In cases where the IORP itself, and not the sponsoring undertaking, underwrites the liability to cover against biometric risk, or guarantees a given investment performance or a given level of benefits, the IORP is required to hold additional assets in the form of regulatory own funds according to the rules currently prevailing for life assurance undertakings (Solvency I). As from 2012, it is expected that new solvency rules will apply to life insurance undertakings (Solvency II). This would mean that from a solvency perspective, different rules will apply to IORPs subject to Article 17 and life insurance undertakings offering similar products.

26 CEIOPS floats the possibility of different security elements combining to result in similar levels of protection but its comments about the lack of a common language mean we currently have no way of knowing when systems are comparable:

− “An overview of the ‘portfolio’ of security mechanisms in place emphasises the diversity of pension systems across Europe. Most countries turn out to approach the issue of effectiveness from an intuitive point of view, based on historical observation, while others are somewhat more specific. The main conclusion, however, is that a framework for the assessment of the combined effectiveness of all individual mechanisms is currently lacking. In particular, no detailed information is available on how, when and to what extent the security mechanisms would interact and operate as a single security mechanism in practice. It would therefore be difficult, if not impossible, to attach a level of overall security to the individual pension systems in a way that made sense.” (CEIOPS Funding Survey, p. 40).

− “There is an apparent interaction between the different elements that make up the pension frameworks across Member States. For example, emphasis on prudent valuation principles, which results in extra reserves, reduces the need for additional security mechanisms. Overall security or solvency cannot be understood without a full appreciation of all the elements involved. A comprehensive analysis of the overall security level provided to beneficiaries requires a common language to encompass all individual elements. Such a common denominator assesses the differences in valuation methods and adjustment mechanisms, as well as their interaction, and thereby estimates the security they ultimately provide.” (CEIOPS Funding Survey, p. 7)
4(a) Competitive distortions

**Question a)** Do you anticipate competitive distortions emanating from the application of different solvency regimes between insurance companies and IORPs subject to Article 17? Please specify.

**AEGON response**

Yes. The clearest (but not the only) case is in connection with those life insurance companies operating under the Article 4 option as 'life insurance IORPs', such as France and Sweden. These are expected to operate under a hybrid regulatory regime in which key parts of the IORP Directive replace key parts of the Life Insurance Directive. However, under Article 4, Article 17 of the IORP Directive is not applied to these life insurance IORPs – nor is there a distinction made between life insurance IORPs who bear biometric and investment risk and those life insurance IORPs where the risk is borne by others. These 'life insurance IORPs' will be expected to operate on the same markets for the same products against IORPs operating under Solvency I rules or, in the case of those non-Article 17 IORPs where risk is underwritten by employers, by IORPs operating outside any EU regulated solvency regime at all.

4(b) Evidence of distortion

**Question b)** Do you have any evidence of such competitive distortions (as mentioned in the previous sub-question) existing already?

**AEGON response**

Yes. See previous answer. The Article 4 approach is unsatisfactory because it tries to use selected provisions from two very different directives to construct a hybrid regulatory regime for life insurance IORPs, for example, basic terms are defined differently. Analogous issues are encountered outside the Article 4 context, whenever life insurers compete or could compete for workplace pensions provision.

The issue of competitive distortion should also be looked at in wider terms. If each Member State can decide on which financial services providers may provide occupational pensions under its pension system, the implications of Member State choices as to which provider-types may have access to occupational pension provision and which provider-types are excluded need to be considered. In certain countries, IORPs enjoy the status of a provider of services of general

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27 See Recitals 9 and 12.
interest. In such cases the corresponding obligations not to abuse possible dominant positions that may arise by virtue of such an economic privilege need to be clarified and, where necessary, enforced. This includes (ab)using its market power to extend its privileged position into other areas.

4(c) Impact of "applying Solvency II"

Question c) What would be the likely impact of applying Solvency II (or similar solvency rules) to IORPs subject to Article 17?

AEGON response

We think any discussion of "applying Solvency II" to IORPs needs to define what this actually means (see General Preliminary Remarks, section 3).

If we mean shifting to a market consistent i.e. economic approach then this will affect how assets and liabilities are valued, as well as how risk is managed and what capital and/or other security mechanisms are required to cope with risk:

- As regards valuation, a transition from more ‘optimistic’ systems of determining assets and liabilities to a more economic approach does not create more liabilities but reveals the true state of affairs. The question of how any difference should be made good is a separate issue but the potential deficit should not be hidden away.

- Applied to non-Article 17 IORPs, the economic approach is also capable of valuing the employer commitment in determining the strength of the security mechanism. The ability to reduce benefit levels and to have a different confidence level should also be taken into account – but such features need to be made transparent to (potential) scheme members in a way that enables them to make rational choices.

Separate from the foregoing, is the question of how transition is managed. Any transition has costs, but these can be minimized by being as smooth as possible.

4(d) Possible impact on DB schemes

Question d) What would be the impact on the future provision of defined benefit schemes and the risk of closing down existing schemes?

28 For example, the European Court of Justice has treated certain Dutch IORPs as being entrusted with "social task of general interest" of Case C-67/96, Albany, ECR 1999 Page I-5751.
AEGON response

A solvency regime based on principles embodying an economic risk-based approach will introduce greater realism into pension provision. This may involve revealing currently understated liabilities. In cases where this reveals underfunding, recovery plans will be needed. The new solvency regime for IORPs should take into account relevant specificities, such as particular security mechanisms. Any new regime should be introduced in an appropriate and sensitive manner.

4(e) Costs and benefits

Question e) What would be costs and benefits of this? Please provide quantitative information, where available.

AEGON response

In the absence of an economic, risk-based common language it is difficult to calculate these. In any event, one benefit would be increased transparency.

4(f) Possible adaptations to "a Solvency II-type regime"

Question f) In case a Solvency II-type regime were to be applied to IORPs subject to Article 17, which elements would need to be adjusted to take account of the specificities of the institutional set-up in which that IORP operates (e.g. recovery plans, additional contributions, flexibility of benefits, etc.)?

AEGON response

The principles of a modern, economic approach do not need adjustment. Their detailed application will via identification of economically relevant factors automatically result in a differentiated approach.

The main difference between a modern solvency regime for IORPs (whether or not subject to Article 17) and the proposed Solvency II regime for insurance companies will be the apparent ability of individual Member States to set different levels of pension security and/or rely on different (combinations of) security mechanisms.
5. **Overfunding**

The IORP Directive requires IORPs subject to Article 17 to hold assets to fund their technical provisions at all times. In the event of underfunding, the IORP is required to establish a recovery plan.

**Question** In case of overfunding can the excess assets be returned to the sponsoring employer or are there restrictions to this (thereby reducing the upside potential for employers)? Does this partly depend on whether occupational pension schemes are closed or open to new members?

**AEGON response**

An IORP is overfunded only if the prudential full-funding requirements are met. Just as national rules may determine who must bear a shortfall in the case of underfunding, what happens to such "excess assets" (i.e. who benefits from it), may also be a matter for national social and labour law rather than the IORP Directive. If this is correct, national rules may decide on how it is to be distributed between sponsors, employees or beneficiaries. (In some cases it may be used to fund 'conditional indexation' in others to pay for 'contribution holidays'.)
This section focuses on IORPs that engage in cross-border business. These IORPs could be IORPs covered by Article 17 of the IORP Directive as well as other IORPs. The main question here is to what extent the differences in the solvency regimes for IORPs that operate on a cross-border basis are creating internal market problems. This main question is dealt with by looking first at the rules relating to technical provisions and then at the solvency rules for IORPs operating on a cross-border basis.

AEGON response to Main Question

There are a variety of reasons for the slow take off of cross-border activity. These include uncertainty concerning the nature of cross-border activity, the nature of the full-funding requirement in a cross-border context, tax issues as well as a need to better understand the interaction between prudential rules and national social policy requirements as applied to occupational pensions. A common language for pensions would facilitate cross-border integration. There should be no separate prudential regime for cross-border providers.

6. Technical provisions

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

6(a) Greater harmonization of technical provisions

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

Greater harmonization is necessary. This must be based on a common language for pensions embodying an economic risk based approach underpinned by a market-consistent approach to valuation. It should be able to reflect differences in cross-border circumstances including legal, economic and demographic variations. This includes national variations in form and level of pension commitments.

6(b) Social and Labour Law and prudential requirements

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

AEGON response

Yes. What is governed by the IORP Directive is a financial services issue and is therefore a prudential requirement. Member State social and labour law concerns issues outside the scope of the IORP Directive.

As the term ‘social and labour law’ implies, it includes issues relating to the relationship between employer and employee. However, the IORP Directive contains several other references indicating what sorts of issues might fall under relevant Member State social and labour law. These include definition and payment of retirement benefits, questions of scheme membership, degrees of solidarity via compulsory membership, collective bargaining, treatment of the self-employed, extent to which family members are covered by a scheme, the nature and extent of ancillary benefits as well as the conditions for transferability. Although the IORP Directive contains no explicit statement of the systemic distinction between prudential requirements and social and labour law, they can be distinguished on the basis of a model of funded pension production process in which the Directive is seen as regulating the ‘production phase’ of a larger process in which contributions from members or sponsors (‘input’) are ultimately converted into pensions (‘output’). Member States freedom to set conditions about scheme membership conditions and form of pensions is a matter of their social and labour law. But the ‘production phase’ is governed exclusively by the IORP Directive and the national financial services rules implementing it – there is no scope for social and labour law to interfere in this area.

However, simply being able to distinguish between the two sets of requirement is not enough. We also need to understand the interaction between the requirements. If Host Member State requirements function as product standards to be met by a home State provider, then these standards feed back up the production chain and have prudential implications. In particular, variations across host State national product requirements impact on the appropriate prudential
rules to be applied by the home State to those IORPs trying to operate in two or more countries.

The implications of this interaction are wide-ranging and profound and not always obvious. There are also overlaps with analogous issues encountered under other financial services directives. AEGON believes that a unified approach should be developed and has developed an initial model for taking these issues forward.

7. **Indexation**

7. The CEIOPS survey shows that in practice, Member States differ markedly in their approaches to inflation protection of the benefits promised. In some Member States they are conditional, in which case inflation risk is left with the beneficiaries, while in others they are unconditional.

7(a) **Differences in indexation promises**

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

**AEGON response**

This may fall under the principle that each Member State retains the competence to define its own product requirements and standards (see General Preliminary Remarks, section 1). This could include indexation and the type of indexation chosen. In a cross-border context, if applied to non-domestic providers, then the same standards (at least) must apply to domestic providers. Differences between nominal, conditional and real forms of indexation will require their separate treatment from a solvency perspective. (In any event, any EU legislation in this area, such as via ‘fair treatment’ or ‘fair adjustment’ mechanisms put forward in the proposed ‘portability’ directive should be consistent with the approach here.)

7(b) **Differences in the specific nature of pension promises**

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

National product specificities which are required by a host Member State for its pensions must be complied with (‘multi-jurisdictional compliance’). This inevitably means that from a demand-side perspective national workplace pensions ‘markets’ will remain fragmented on national lines but integration is possible on the supply-side.

The two main challenges posed by the principle of a host State competence to define its pension product standards are:

- making those standards sufficiently clear so that a non-domestic provider can adjust its production process accordingly and so that a home state supervisor is in a position to determine whether that provider can deliver the product as specified;

- the need for cross-border IORPs to embody a sufficient degree of internal structure and complexity so that they can adjust their processes to accommodate for different national product environments and that these processes are also sufficiently transparent for supervision to ensure multi-jurisdictional compliance.

8. Solvency rules

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

8(a) Effects of differences in national solvency rules

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

AEGON response

All differences between national situations generate friction for cross-border mobility and in the worst case are barriers. In the EU, pension systems have an inherently national dimension. This means that, for example as regards product definition, some degree cross-border friction will be inevitable and will only begin to be reduced if we start to move towards a single European social space.

I.e. there could be ‘pan-European’ competition between suppliers to supply distinct national markets.
Differences between national pension requirements have an impact on the appropriateness of particular prudential rules. This appears to imply that Member States aiming to be locations of choice must have an adaptable solvency and prudential framework that can be adjusted in a transparent way to meet the product requirements set by host State countries. (If the framework is not flexible, then it could be that an exporting IORP is operating at higher or lower standards than are necessary in the host Member States. This could result in the wrong sort of arbitrage or simply discourage cross-border activity.)

But designing a truly flexible and adaptable system (which is not simply loose or vague) is a challenge.

As long as prudential and solvency rules are tied to respective national pension promises, and information and tax requirements vary, then cross-border differences can be reduced but not eliminated.

8(b) Other potential complications

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

**AEGON response**

There are other reasons (prudential and non-prudential). They include the following:

- As highlighted by CEIOPS, there is a lack of clarity amongst Member States on what actually constitutes cross-border activity.\(^{30}\) Is it when the employer is in a different Member State than the IORP? Or is it employee location that should be decisive? Or should it be when the nationality of the law of the pension scheme is different from the law of the IORP?

- Multinationals are often regarded as potentially benefiting from the Directive, but the Directive does not explicitly address issues that can arise in connection with multinationals. For example, the identity of the sponsor in the sense of the IORP Directive may not always be clear in the context of a multinational.\(^{31}\)

\(^{30}\) CEIOPS IORP Report, pages 15, 58-60.

\(^{31}\) See definition of “sponsor” in Article 6(c). Employees in multinationals may have a base company with whom they retain a long term employment relationship but at the same time have an employment contract with another group company to whom they have been assigned. Issues of sponsor identity may also arise where contributions are paid by different entities within the group.
- The funding requirements for cross-border providers are not clear. These concern the meaning of the requirement in Article 16(3) for the total range of pension schemes operated to be fully-funding as well as the issue of how to deal with underfunding should it arise.

- Taxation is also frequently cited as the main barrier.

9. Regulatory arbitrage

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

9(a) Evidence of regulatory arbitrage and/or supervisory competition

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

AEGON response

Forms of regulatory arbitrage where differences between national rules still mean that host State product requirements are satisfied in full ('positive arbitrage') need to be distinguished from situations where the products provided only superficially resemble what is required by a host State ('negative arbitrage'). (On positive and negative arbitrage – see response to Question 9(c).) There do appear to be some initiatives by Member States to become locations of choice for cross-border workplace pensions business.

At present due to the lack of a common language for pensions and a clearer understanding of how social and labour law requirements interact with prudential requirements make it difficult to distinguish clearly between positive and negative forms of arbitrage or whether supervisory competition is negative or positive in character.

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32 Does the full-funding requirement in Article 16(3) as linked to the possibility for non-domestic schemes to be 'ring-fenced' imply that domestic operations may be underfunded (as long as they comply with any national rules that implement the option in Article 16(2))? Is it possible to use 'excess' funds from one fund to offset a shortfall in another?

33 The ring-fencing requirement in Article 16(3) should imply that domestic operations may be underfunded in line with national rules implementing the option in Article 16(2). The full funding requirement cannot prohibit the possibility of a fund becoming underfunded but it prevents the application of 'tolerant' underfunding and recovery regimes that are possible under Article 16(2).
9(b)  Future regulatory arbitrage and/or supervisory competition

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

**AEGON response**
See responses to 9(a) and 9(c).

9(c)  Desirability of regulatory arbitrage and/or supervisory competition

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

**AEGON response**
Arbitrage may take positive and negative forms.

- Two Member States may both have regulatory or supervisory systems designed to ensure that IORPs operating in their territories deliver pensions satisfying the same product standard. But one country may use ‘smart legislation’ whereas the other country includes excessive red tape. In such a case, an IORP could operate more cheaply in one country than in another to produce the same outcome. This is justifiable regulatory competition, ‘positive arbitrage’, with efficiency gains allowing quality pensions to be delivered at lower cost. This would be in the interests of both beneficiaries and sponsors.

- By contrast, one country’s regulatory or supervisory system may simply be based on ‘lax legislation’, unlikely or incapable of satisfying the product standards set by a host State, whereas yet another Member State’s system is capable of ensuring compliance. Unlike ‘smart legislation’, ‘lax legislation’ involves a sub-standard version of another product being passed off as a higher quality product. This is ‘negative arbitrage’ and is against the interests of members.

But the two forms of arbitrage need to be distinguishable in practice. In the context of the IORP Directive, a host State needs to have clear and objective product standards (with which, of course, domestic providers in that Member State must also comply). A home State needs to understand which home prudential rules
would ensure proper delivery of products satisfying host State requirements. But such clear and objective product standards are only possible with a common language for pensions based on an economic risk-based approach which takes a market-consistent approach to valuation. The IORP Directive in its current form lacks a methodology for systematically linking (home) prudential requirements and (host) product requirements. This lack of transparency makes it difficult to know whether mere compliance with home State prudential rules will fulfil, fall-short of, or over-fulfil a host State’s requirements, i.e. we have no way of distinguishing ‘positive’ from ‘negative’ arbitrage.

9(d) Solvency rules for cross-border IORPs

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

**AEGON response**

Yes. They should take into account the specificities of the particular pension commitment and be based on a market-consistent valuation of assets and liabilities (common language).

The solvency principles applying to cross-border providers should be the same as those for domestic providers. There should not be a separate regime for cross-border providers.

9(e) Who defines levels and method of risk orientation

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

**AEGON response**

In any event there should be a common methodology set at EU level. If there are to be different levels of security set at national level these should be objective and transparent and on the basis of the common methodology (common language).

9(f) Governance and disclosure

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

Introducing ‘Pillar 1’ (quantitative requirements) alone without appropriate ‘Pillar 2’ (governance and risk management) and ‘Pillar 3’ (disclosure/transparency) requirements, will not mean that the resulting new solvency system embodies an economic, risk-based approach. The three Pillars need to be in place and provide interacting, mutual support. Therefore, rules on governance and disclosure need also to be included.

10. Significance of different valuation methods and security mechanisms

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

10(a) Harmonized solvency rules for cross-border IORPs

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

AEGON response

A common language relying on a market-consistent valuation basis as a harmonized methodology is desirable. This would still allow for national variations. A uniform, ‘stand alone’ solvency regime for all cross-border IORPs which is separate from the regime for domestic IORPs should be avoided.

10(b) Harmonization of limited elements for cross-border IORPs

**Question b)** Do you think that in some parts or elements of the solvency regime there is scope for harmonisation? If so, for which parts or elements?
AEGON response
A common language as a harmonized methodology is desirable.

10(c) Different types of cross-border IORP

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

AEGON response
A common language as a harmonized methodology is desirable. This would still allow for national variations.

10(d) Possible problems to a harmonized approach to cross-border IORPs

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

AEGON response
Harmonization of methodology should apply to both domestic and cross-border providers. The challenges involved have been outlined above (response to Question 6(b)). In particular there is a need for a common language for pensions and to understand the interaction between (host State) social and labour law requirements and (home State) prudential rules.

10(e) Current solvency regimes for cross-border IORPs

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

AEGON response
No.