CONTENT

• The “Holistic Balance Sheet”: A future regulation concept for occupational pension provision?
  Dr. Roberto Cruccolini, AKA - Germany  
  3

• The Portability Directive – The condemned live longer
  Hagen Hügelschäffer, EAPSPI / AKA  
  16

• Occupational pension in Europe – Pension security through diversity and awareness
  Aitor Emaldi, Elkarkidetza - Spain  
  20

• The European Court of Justice condemns different treatment of the insured person the basic of their sex
  Elena Marisol Brandolini  
  22
EDITORIAL

In 2012, the issue of pensions will again be significantly impacted by European developments. First of all, the official publication of the “White Paper on Pensions”, the draft of which already emerged at the end of last year and which includes a range of concrete proposals conducive, in the view of the Commission, to creating and safeguarding adequate, sustainable and safe pension systems.

Above and beyond the White Paper, the Commission is already expressing proposals for concrete measures in 2012, in particular with respect to supplementary pension systems. The first of these is the so-called portability directive, through which the Commission wishes to further the mobility of workers, first and foremost by creating minimum standards for accrual and preservation of dormant pension rights. Although the initial directive proposal was not adopted by the Council at the time due to the opposition of certain Member States, we can expect an amended version to be presented this year. The reasons that prompted the Commission to come back to this theme are discussed in this issue of EPB.

Furthermore, the Commission, along with EIOPA, will be continuing its consultations in the weeks and months to come, with a view to publishing a draft amendment of the Pension Funds Directive, probably by the end of 2012. To prepare this work, EIOPA undertook a public consultation from the end of October to the beginning of January. On 517 pages, it presented 96 questions on the future content of the Pension Funds Directive. The holistic balance sheet approach discussed by EIOPA which would appear, on the face of it, to ease the concerns related to application of the Solvability II directive to Institutions for Occupational Retirement Provision, is also analysed and explained in detail in this issue.

In 2012, supplementary pension systems will also be a hot topic for countries where pension systems are based more or less exclusively on the first pillar. This is the case, for example, of the Spanish pension system, which requires far-reaching reforms in which implementation of generalized supplementary pension systems could make a significant contribution.

Some interpretations of the Maya calendar predict that the end of the world will be on 21.12.2012. At this point, the only thing we are sure of is that the decision of the European Court of Justice in the “Test-Achats” case stipulates that the prices applied to new insurance contracts must be unisex as from that date, and the deadline of 21.12.2012 arises directly from the provisions of Article 5 (2) of the disputed directive 2004/113/CE. The last part of this issue of EPB offers a detailed presentation of the said decision, including its practical consequences.

Kind regards

Hagen Hügelschäffer
The Holistic Balance Sheet (HBS) is an extended solvency balance sheet concerning institutions for occupational retirement provision that the European Insurance and Occupational Pensions Authority (EIOPA) has developed in the course of the current review of the EU Pension Fund Directive. The HBS does not represent a regulation concept in itself but takes up, according to the explanations provided by EIOPA, the essential principles imposed by Solvency II in respect of own funds. The HBS should however include all the financial resources that are in principle available and all the security mechanisms that occupational pension institutions have available to them in emergency situations. This could consist of additional payments by employers, insolvency protection thanks to pension security systems or possible reductions of benefits. In fact, the HBS is an attempt by EIOPA to include specific essential characteristics of occupational pension provision within a regulatory framework, taking the Solvency II directive for insurance undertakings as an example.

In this text, we will start with a brief outline of the key data and the reasons that have led to the current review of the Pension Fund Directive (I). We will then explain the operating mechanism of the HBS, first examining the calculation of the capital requirements in compliance with Solvency II and then its extension through the HBS (II). After a presentation of the advantages of the HBS from the viewpoint of EIOPA (III), we will discuss the disadvantages of the HBS and of the Solvency II regulation concept from the viewpoint of occupational pension institutions (IV), before drawing our conclusions.

I. The Pension Fund Directive and its review: An overview

To understand why EIOPA even developed the HBS concept, it is necessary to shed some light on the reasons for the current review of the Pension Fund Directive (2003/41/EC). This European Directive on pension funds, regulating the economic activities and supervision of institutions for occupational retirement provision in the European Union, has existed since 2003. It is based on the consideration that “occupational retirement pensions will increasingly be relied on as a complement to social-security pensions in the future” and that development of savings should be encouraged. For that reason, investments made must comply with the prudent person principle and there has been an attempt to better harmonize supervision standards so as to promote cross-border activities and European competition. In the view of the EU Commission, the Pension Fund Directive was to constitute a first step towards a single European market for occupational pension provision.

With its Green Paper “towards adequate, sustainable and safe European pensions systems” in July 2010, the European Commission placed the issue of occupational pension provision back on the political agenda and thereby started a review of the current Pension Fund Directive. In March 2011, the Commission sent a Call for Advice (CfA) to EIOPA, to identify to what extent the current directive on pension funds needed to be reviewed and improved based on the developments of the last years. To prepare its reply to the Commission, EIOPA undertook two consultations with stakeholders: a first consultation dated 8 July and 15 August 2011, with a rather limited scope and a second, much broader, consultation, between 25 October 2011 and 2 January 2012. In its second consultation, EIOPA finally presented its holistic balance sheet approach. Moreover, EIOPA programmed a quantitative impact study for the summer of 2012 and the Commission scheduled

1 See Whereas clauses (5) and (6) of the Pension Funds Directive.
the publication of a first draft directive for the end of 2012.

The reasons of the Commission for reviewing the Directive

In the view of the Commission, there are three main reasons for reviewing the Pension Fund Directive (CfA 1.2.).

1. First of all, the Commission would like to improve the environment for institutions operating EU wide, in order to achieve more competition within the EU and also foster the creation of a single European market for occupational pensions. To date, there are only approximately 80 institutions for occupational retirement provision in Europe operating cross-border. Compared with approximately 140,000 such institutions in the EU, the Commission considers that this figure is low and that it indicates insufficient “minimal harmonization” set forth in the current directive and that other simplifications in terms of law, supervision and administration will be required.

2. Secondly, the Commission wishes to modernise regulation for occupational pension institutions which operate defined contribution schemes (Defined-Contribution-(DC) or Hybrid-Schemes). Over the last few years, partly because of the enlargement of the EU to the east, defined contribution schemes have gained increasing importance. Today, almost 60 million Europeans rely on adequate pension income thanks to this type of scheme, which, however, involves the disadvantage of transferring the risks inherent to negative developments on capital markets, those linked to increased longevity or to inflation from the occupational pension institution to the beneficiary. For that reason, the Commission believes that the regulations applicable to institutions for occupational retirement provision operating defined-contribution schemes should be adapted.

3. As a third reason, the Commission mentions implementation of a risk-based supervision system even in the field of occupational pension provision, as it is in particular since the financial crisis of the autumn of 2008 that it appears necessary to better assess risks, to take into account and develop risk-mitigating processes and to identify security mechanisms.

The HBS: An extension of Solvency II as (EIOPA’s) answer to the call of the Commission?

This third point, namely reorganisation of the supervision system for occupational pension provision with a focus on risk orientation, should be analysed against the backdrop of a fundamental reorganisation of supervision systems for the banking sector (Basel II/III) as well as for insurance undertakings (Solvency II) implemented over the last few years. This new regulation system is characterized by a three-pillar structure. On the one hand, it includes standards relating to capital requirements own funds that are more developed, risk-based and result from the specific risk profile of the undertaking (Pillar I). In addition, there are requirements related to internal supervision within the company (i.e. risk management and governance) and external supervision by the supervisory authorities (Pillar II) and the obligation to provide detailed information to the supervisory authorities and the public (Pillar III). The main objective is to prevent insolvency and thereby to provide, at individual level, more protection for the consumer, and at macro-economic level, greater financial stability.

This involves a challenge for EIOPA, namely that of appropriately taking into account the specificities of occupational pension provision. Michel Barnier, the EU Commissioner for Internal Market and Services, clearly expressed this during the first annual EIOPA conference held in Frankfurt a. M. on November 16, 2011: “Now is the time to build a modern and innovative system founded on risk management, corporate governance and effective supervision, inspired by the Solvency II Directive and taking into account the special characteristics
of institutions for occupational retirement provision.” At the same conference, EIOPA President Gabriel Bernardino emphasized that in the 2nd consultation, EIOPA had found a possibility to meet the challenge thanks to the Holistic Balance Sheet concept. According to Bernardino, the HBS is “the right way forward in ensuring a future harmonised and risk-based supervisory and regulatory framework for IORPs”, given that it allows “recording and measuring on a consistent basis the obligations and resources, including both assets and security mechanisms, of an IORP”.

Such is the initial context of the HBS. And it is only against this backdrop that the HBS can be understood. The HBS is, on the one hand, an answer to the wishes of the Commission and to the above-mentioned reasons why the existing Pension Fund Directive should even be reviewed. On the other hand, it represents a concept that in the view of EIOPA is able to take into account the specific characteristics of institutions for occupational retirement provision. And Solvency II, the regulation system that has since been raised to the level of “state-of-the-art”, constitutes the blueprint for the answer to the question of the future form of the review.

This impression is confirmed if one examines the voluminous second consultation document (517 pages). EIOPA focuses in detail on the different articles of Solvency II and discusses the advantages and disadvantages of their possible inclusion in a revised Pension Fund Directive. It therefore appears necessary to take a look at the provisions of the Solvency II Directive in order to better understand the form that a possible revised Pension Fund Directive could take. In order to understand how the HBS works, it is necessary to take a closer look at the requirements of Solvency II in respect of own funds.

II. What exactly is the HBS and how does it work?

Based on what can be understood at this point from the explanations provided by EIOPA in the second consultation, the following aspects are important for an appropriate understanding of the HBS: The HBS is not based on a self-dependent regulatory conception. The HBS is in fact based on the 1st Pillar of Solvency II – on the basic principles (market consistency and risk sensitivity) and on the calculation of the necessary level of own funds, the so-called solvency capital requirement. This is based on chapters 9 and 10 of the consultation document. The significant novelty of the HBS lies in the list of recognized assets that, according to the explanations provided by EIOPA in Chapter 8.3., consist in particular of additional future payments by employers, pensions protection schemes and possible benefit adjustments. Based on this, we will begin the next section by explaining the calculation mode of the solvency capital required according to Solvency II.

Calculation of the solvency capital requirement according to Solvency II: Two principles and threestep process

There are two fundamental principles for calculation of the solvency capital requirement:

- The **market consistency principle**: Valuation of assets, liabilities and provisions is consistent with the market.
- The **risk sensitivity principle**: The capital requirement is calculated based on the specific risks faced by an undertaking.

These principles represent the starting point of the comprehensive and detailed provisions of the Solvency II Directive (2009/138/EC) in Articles 75-144. To illustrate what is meant, the text first presents in a schematic and very styled manner...
the process to calculate the required solvency capital. This process involves three steps: In the first step, a market value balance sheet is drawn up. In the second step, this market value balance sheet is subjected to “stress”, meaning that the market value is determined in the event of an extremely negative evolution of the different risks. In the third step, finally, the difference between the own funds of the market value balance sheet before and after the stress is calculated. This amount corresponds to the solvency capital requirement that undertakings must cover with their own funds.

1st step: Drawing up a market value balance sheet
Irrespective of the accounting standards by which an undertaking usually draws up its balance sheet (commercial code, IFRS, etc.), Solvency II first and foremost requires that an additional independent “solvency balance sheet” be drawn up, which will be used only for supervisory purposes (see figure 1). For this balance sheet, valuation of all items is consistent with the market (based on the so-called “transfer value principle” in Article 75 of the Solvency II Directive). This means that valuation of assets is based on market values, or if no market prices exist, on a model relying on market information. Amortisation of undisclosed reserves increases the market value of assets items in a Solvency II balance sheet. The value of technical provisions corresponds to the “best estimate”, i.e. the most probable average value taking different scenarios into account, calculated without “security buffers” in respect of interest rates, mortality tables and other factors. This decreases the market value of technical provisions compared to the value of the Solvency I balance sheet. Moreover, an explicit risk buffer is calculated at the best estimate level.

4 Another problem is that under Solvency II EIOPA is now imposing the “risk free” rates curve to discount the provisions. Owing to this approach that consists of using an interest rate for “safe” investments for discounting, we obtain a significant increase in provisions in particular when interest rates are historically low.
5 When such information is available on the financial markets, the value of technical provisions corresponds to the value of financial instruments that replicate the probable cash in and out flows linked to obligations (the so-called hedgebale liabilities, Art. 77 (4), paragraph 2 of the Solvency II Directive).
2nd step: The market value balance sheet is subjected to “stress”

The market value balance sheet is now subjected to stress. This means that a significant aggravation of the various risks is simulated and the impact on the market value balance sheet is examined. Solvency II imposes various risk categories on the assets and on the liabilities side. On the assets side this is foremost the market risk module with a series of sub-modules such as interest rate risk, equity risk, credit risk, property risk, etc. With regard to the liabilities side there are actuarial risk categories, for example risk related to life insurance, non-life insurance, etc. and their respective subcategories. Each undertaking must take into consideration all the risks to which it is exposed. To date, the risks have been identified and specified only in the so-called quantitative impact studies for insurance undertakings (QIS 1-5). For each risk category and its partial risks, EIOPA has imposed either deterministic shock scenarios or so-called “stress factors”, the scope of which is supposed to correspond to very rare occurrences. For example, in QIS 5, the normal equity price risk corresponded to a 39% drop (= the given stress factor) of EU and OECD indexes, with other values deteriorating by 49%.

The strength of these shocks expresses the high level of security required by Solvency II, that sets forth a 1-year Value-at-Risk (VaR) corresponding to a confidence level of 99.5%. This means that a certain loss must not be exceeded within a period of one year with a probability above 99.5%, meaning that the required 99.5% security level corresponds to a frequency of 1 occurrence in 200 years. In Solvency II, the amount of the loss corresponds to the possible negative changes in net equity caused by the partial risk over a period of one year (that is expressed by the stress factors or the shock scenarios). Therefore the VaR requirements in respect of solvency capital
requirements according to Solvency II are hidden in the level of stress factors and shock scenarios.

3\textsuperscript{rd} step: Solvency capital requirement = difference between net equity before and after the “stress”

The solvency capital requirement then results from the difference between the net equity at market value before and after the aggravation of the risks (see figure 2). First, the capital requirements are calculated separately for each partial risk category, where the individual risk categories are “stressed” as described above. The separate capital requirement here corresponds to the negative variation of the value of net equity provoked by the aggravation of a given partial risk. An example of a risk for the assets side of the balance sheet would be a 39% drop in an EU share index as mentioned above. To illustrate prudential risks, we could imagine, for life insurance, an unexpected increase in the longevity of the insured, for example that all the beneficiaries live 15% longer than initially planned when the provisions were calculated. Figure 2 provides an illustration of these two risks. Due to a drop in equity prices, the value of assets drops in the “stressed” Solvency II balance sheet. And owing to increased longevity, the value of provisions increases. Both factors lead to a drop in net equity in the “stressed” Solvency II balance sheet (in purple in figure 2). The difference net equity before and after the stress corresponds to the amount of the solvency capital requirement. This process is first applied separately to each partial risk, meaning that the separate capital requirements are calculated for each of the partial risks and are then cumulated to determine the solvency capital requirement taking into account diversification and cost-reducing effects.\textsuperscript{6} The figure does not take these into account in order to better illustrate the basic principle.

![Figure 2: The solvency capital requirement calculation according to Solvency II](image-url)
In the end, the solvency capital requirement is supposed to correspond to the specific risk profile of an insurance undertaking given that - contrary to the Solvency I Directive - the amount of the solvency capital requirement is now determined based on all the economic risks to which an undertaking is exposed. In simple terms, in compliance with Solvency II, an undertaking must ask itself: How much is my insurance portfolio costing in terms of capital requirements? And how much are my investments costing in terms of capital requirements? The answer is found by drawing up a market value balance sheet, by subjecting this balance sheet to “stress” in compliance with the prescribed stress scenarios and shock factors for the individual risk categories and by determining the change in net equity provoked in this manner. This then gives the amount of the capital requirement.

**The HBS and taking into account additional security mechanisms of occupational pensions**

We now have the necessary knowledge to illustrate how the Holistic Balance Sheet works. The substantial difference between the HBS and a “pure and simple” application of Solvency II lies in the fact that for the calculation of the capital requirement as understood by the HBS, all the available financial resources and all the security mechanisms that occupational pension institutions have in emergency situations are to be taken into account in the market value balance sheet as “new assets” (or as a reduction of liabilities), hence the term “holistic”, because the idea is to analyse the financial situation of an occupational pension institution by means of a comprehensive approach. When it is said that the specific characteristics of occupational pension provision are taken into account in the HBS, this is specifically a reference to these new assets.

EIOPA has divided these additional financial resources into three categories:

1. **Contributions stipulated upstream from the sponsor undertaking**, paid to the institution for occupational retirement provision, triggered by a given situation (such as, for example, underfunding etc.). These binding commitments could take the form of fiduciary accounts or of pledging of property owned by the employer.

2. **Other future contributions from the sponsor undertaking pension protection systems**. Future contributions could include, for example, payments from the employer spread out over time or predetermined emergency plans.

3. **Possible readjustment of benefits**

These components are then integrated into the system described above. They appear in green in figure 3. This means nothing other than that additional binding contributions from employers and future contributions from employers and pension protection systems are included on the assets side of the balance sheet as additional assets, the possibility of reducing benefits being considered as a reduction of technical provisions, based on the concrete existence of such components within an institution for occupational retirement provision.

---

7 The solvency capital requirement must be covered by certain types of capital or “own funds”, whose “eligibility” is determined based on the quality of the guarantees. For such “eligibility”, the decisive criteria are the “constant coverage of losses” in the event of continuance of the undertaking and “subordination” with respect to other claims in the event of insolvency.

8 See sections 8.3.6. and in particular 8.3.34 and following of the 2nd consultation document.
Although it is not yet possible, for lack of concrete provisions, to assess with precision how the assets, liabilities and net equity will vary when changing from Solvency II to HBS, there are already clear trends: Assets increase, liabilities drop and the own funds or solvency capital increases accordingly. For that reason, with the HBS, institutions for occupational retirement provision would be better equipped to cover the rising solvency capital requirement (owing to application of the Solvency II system).

In pages 82 to 84 of the consultation document, EIOPA provides several examples of application of the HBS to different types of occupational pension schemes. In particular, the document differentiates those who will, in fine, be exposed to market risks, technical risks and other risks (the insured, the employer or the pension institution). EIOPA also considers a more detailed classification of these new assets. In simple terms, the document examines to what extent the contributions promised will concretely commit the employer and to what extent they will be reliable and available, hence the segmentation by EIOPA in the additional contributions of the employer. The contributions of an employer who would have a binding commitment to make them in a predetermined situation benefit from a better assessment as they are more precise, perhaps even guaranteed and therefore offer a rather high level of security. On the other hand, contributions based on the promise of additional future contributions by an employer are considered to be less reliable as they also depend on the future solvency and performance of the employer. It should be said that there are still many unsolved
issues, some of which even concern essential problems (such as the issue of whether it will be allowed to count the new assets in the “non stressed” balance sheet already, or what concrete value will be given to a pension protection system). The HBS approach is therefore not an entirely new regulation approach, but maintains the basic principles of Solvency II (market consistency, risk sensitivity) and the concept of the solvency capital requirement. Thus, according to the HBS approach, even an institution for occupational retirement provision must ask itself how much its pension liabilities cost in terms of capital requirements and how much its investments cost in terms of capital requirements. It must also, therefore, draw up a market value balance sheet, subject the balance sheet to “stress” and calculate the resulting variation in net equity. However, an occupational pension institution is allowed to record all the financial resources that are in principle at its disposal and all the security mechanisms as “new” assets in the solvency balance sheet – hence the name “holistic”, and that is what should be understood when EIOPA indicates that the HBS takes into consideration the specificities of institutions for occupational retirement provision.

III. The advantages of the HBS – from the viewpoint of EIOPA

From the viewpoint of EIOPA, the HBS offers a range of advantages. The indications in brackets below refer to the relevant sections of the 2nd consultation document.

The HBS is a supervisory tool that, according to EIOPA, makes it possible to implement a risk-based supervision system for IORPs which, in principle, takes into account the regulation concept set forth in Solvency II. In that sense, the HBS would comply with the requirements of the EU Commission. As we have already described in detail, the principles of “market consistency” and “risk sensitivity” remain the essential evaluation criteria making it possible to define prudential own funds requirements in the HBS (8.3.3., 8.3.6., 8.3.14.). The HBS also makes it possible to take into account and to include in the balance sheet the additional resources and security mechanisms specific to occupational pension institutions, making them measurable, comparable and economically assessable (8.3.6.). This would as of now provide a consistent approach to valuation of assets and liabilities and security mechanisms. In the view of EIOPA, this would in future make it easier to establish that IORPs offer a similar level of security, irrespective of the security mechanisms applied concretely on a case by case basis (8.3.12.). According to EIOPA, the HBS will not be restricted to a harmonization at the level of the existing security mechanisms. It will also offer a unique accounting mechanism for all types of occupational pension institutions irrespective of who would, in fine, bear the risks of negative developments (capital market risks, longevity, poor management, etc.), whether the occupational pension institution, the sponsor undertaking 10 or the future beneficiary in the case of a defined contribution scheme (8.3.53., 8.3.58.). According to EIOPA, therefore, the HBS offers a risk-based regulatory approach which is harmonized at the level of the essential aspects (valuation methods, security mechanisms, underwriting) – thereby meeting the requirements set forth by the Commission.

IV. The disadvantages of the HBS – from the viewpoint of occupational pension provision

From the viewpoint of IORPs, however, the HBS involves some disadvantages linked to the way in which the HBS takes into account and includes specificities inherent to occupational pension provision. This is all the more problematic given that it arises from the supposed opinion of EIOPA

---

9 Also see section 4 of this article on the disadvantages of the HBS from the viewpoint of occupational pensions.

10 This differentiation is addressed in article 17 paragraph 1 of the existing Pension Fund Directive.
(see the quote from EIOPA President Bernardino in section I) that HBS will be able to transpose to occupational pension institutions a regulatory structure similar to Solvency II. The spectrum of reactions therefore ranges from slightly sceptical objections to fundamental criticisms.

Concrete problems: The implementation of the HBS

The above-mentioned question on the quantification of the new assets remains open: What amounts should an occupational pension institution show in the HBS for an obligation to assume liabilities or a subsidiary liability of the employer? Or for the fact that it is a member of an occupational pension protection institution? There are still significant uncertainties here, as well as subjective room for manoeuvre and possibilities to influence the valuation. And should these “new” assets be included in the balance sheet at the “unstressed” market value with the result that such values, which are difficult to quantify, could become a sort of blank cheque in the event of insufficient cover. All these questions reveal the significant problems and the arbitrary nature of a plausible valuation and a quantitative evaluation of the security mechanisms arising from the very essence of the said security mechanisms which do not comply with the objective of drawing up a neutral, objective and informative balance sheet.

This directly gives rise to another problem: Shouldn’t the “new” assets of IORPs appear elsewhere, under the “new” liabilities item with the sponsor undertakings, for example? If the pension institutions included these new assets in the balance sheet because the partial transposition of Solvency II rules has increased solvency capital requirements, the sponsor undertakings would have to include these liabilities – something which was supposed to be avoided by opting for occupational pension provision internal to companies. Owing both to the increased requirements in capital and to higher personnel, administration and technical expenses, there would be an increase in costs, irrespective of whether there is an actual flow of funds or whether it is purely on the balance sheet. The result would be that many companies would withdraw from occupational pension provision.

Another observation made by EIOPA in its consultation document (the information in brackets refers to the sections of the 2nd consultation document) can also be considered to be surprising: EIOPA confirms that there are already a host of security mechanisms that occupational pension institutions can rely on in emergency situations to varying degrees (8.2.26.; 8.3.6.). According to EIOPA, the purpose of the HBS is therefore essentially to make these security mechanisms measurable and consequently comparable (8.2.28.). Concerning aspects falling outside this perimeter, such as for example the issue of whether employers should as a matter of principle be involved in covering risks or what level of security should be required for direct liabilities, EIOPA cannot, based on its own statements, give any technical advice given that these issues, in essence, call for political decisions (8.2.27.; 8.2.38.).

This leads us to an essential but in fact contradictory aspect that can be linked to the HBS: the starting point is the previously mentioned issue of quantification of the new assets, therefore the issue of the concrete value of a subsidiary liability of the employer in the solvency balance sheet of an occupational pension institution. From a purely economic viewpoint, subsidiary liability represents a comprehensive liability of the employer. In an emergency situation, the employer must pay the liabilities that the occupational pension institution can no longer cover. This type of asset would then be a sort of back-up value that could, as required, absorb the increased own funds requirements under Solvency II.

The result would however be surprising, to say the least: If the new assets were indeed to play this back-up role, the level of security for future beneficiaries would in fact remain unchanged, with or without the HBS. The actually available security mechanisms would remain unchanged, but they would become consistently measurable and would appear explicitly in the balance sheet, as
suggested by the above-mentioned extracts from the EIOPA consultation document. But with the HBS, the costs to guarantee the previously already achieved level of security would increase significantly. In other words, the existing security mechanisms make it possible to guarantee, at this point in time and at a lesser cost, a level of security as high as that to be reached by implementing the new prudential system and the HBS which would be much more costly and consequently more difficult to finance. This is what one might term the “Holistic Balance Sheet-Paradox”.

However, it appears unimaginable from a political viewpoint that occupational pension institutions could receive such a blank cheque on the balance sheet. Given that concrete and plausible quantification of such an asset still appears very vague, this amounts to granting such assets a lump-sum value or a percentage compared to the lack of own funds observed under Solvency II. We would then abandon the initial objective which was to create, thanks to Solvency II and to the HBS, an appropriate risk profile taking into account the financial resources available as a matter of principle and the implementation of risk-mitigating security mechanisms intended for occupational pension institutions in emergency situations.

Beyond that, an analysis from the viewpoint of occupational pension institutions could bring out other factors that additionally support the security of benefits to pension beneficiaries. This could, for example, be the paritarian employer-employee representation on committees ensuring balanced and transparent management as well as equal representation in decisions on benefits, financing etc. Institutions for occupational retirement provision are also social institutions, which makes it possible to structurally avoid potential conflicts of interest between protection of consumers, on the one hand, and increased profit, commissions and dividend payments on the other hand.

**Fundamental issues: The Solvency II matrix of the HBS**

In addition, from the viewpoint of occupational pension provision, there are all the fundamental problems intrinsic to Solvency II and consequently also to the HBS with its matrix borrowed from Solvency II.

A significant institutional difference between the insurance market and occupational pensions is that the rights accrued within an occupational pension scheme are not a negotiable product given that the employer, in light of his obligation to assume liabilities, is, so to speak, involved in the payment of benefits. The 2-party relationship (insurance – insured) therefore becomes a 3-party relationship (pension beneficiary – pension scheme – employer), which results in an additional level falling within the scope of labour law. That is why the idea of “portability” and of the “transfer value” as the general starting point of Solvency II and, more specifically, for the valuation of technical provisions for occupational pensions is not adequate and in fact meaningless. And for the same reason – namely that the employer intervenes as an additional guarantor of benefits and that there is a right to benefits within the scope of labour law – a (future) pensioner is not an ordinary consumer and the motto “more consumer protection” should be considered with caution in the field of occupational pension provision.

From an economic viewpoint also, there are certain essential differences. This begins with the structure of the liabilities which, compared to those of banks and insurance undertakings, are long-term liabilities and are also very “stable”. This means that the liabilities of a pension institution become due only in predefined pension cases and consequently that the need for constant availability of capital to cover short-term assets-side risks and variations is significantly lower – this differentiates occupational pension institutions from banks. The reaction time to liabilities-side deteriorations is also significantly longer, which also requires less available capital in the short term – this

---

11 This aspect is also addressed in the 2nd consultation document. Even EIOPA expresses the opinion that “there is doubt that a principle based on transfer value has conceptual meaning” (sub-section 9.3.6.f. of the 2nd consultation document), where the employer is involved in guaranteeing the benefit.
differentiates occupational pension institutions from insurance undertakings.

This can have different consequences. In light of their long-term and stable liabilities, occupational pension institutions can focus on a capital investment policy in the very long term. Given this long-term investment policy, one can only ask whether the structure of the solvency capital requirement set forth in Solvency II and the risk assessment approach, the previously mentioned Value-at-Risk over 1 year, are really relevant for the regulation of institutions for occupational retirement provision. Another question is the relevance of market-consistent evaluation of assets in the solvency balance sheet where there are investment strategies involving keeping securities such as for example government bonds until their maturity date, so that short-term variations in value are insignificant (for example in a trade balance sheet). For those items on the assets side which are effectively negotiable in the medium term and which therefore fall within the trade portfolio, it may be relevant to apply a risk measurement such as the Value-at-Risk and to consider a period or a keeping period of 1 year. In the framework of a solvency balance sheet, the risk inherent to an asset is closely linked to the maturity date of the liability that the asset in question is supposed to cover. In short, the risk factor inherent to certain assets is a question of time and of the other assets in my portfolio.

A similar point can be made concerning the risks inherent to the liabilities side of the balance sheet. Owing to the long-term and stable structure of liabilities in the field of occupational pensions, there is a significantly longer reaction time to liabilities-side risks. For example, in the event of an aggravation of the longevity risk, leading to an average increase of one year in the age of the pool of current or future pension beneficiaries, compared with the basis for calculation of the book reserves, this means that to fulfil the benefits owed, there is naturally a need for more capital. Contrary to a “standard” risk in damage insurance (such as, for example, a natural disaster), this capital does not necessarily need to be immediately available to cover the risk. It is simply sufficient to cover, by means of additional capital, that part of the capital needed to pay the current pensions for a defined period of time. The reaction time to constitute capital for all the liabilities is definitely longer. One could therefore ask to what extent the 1-year horizon in respect of the solvency capital requirement could give rise to requirements that are too high in terms of own funds for liabilities-side risks, because there would constantly be a requirement for sufficient capital for events that do not need such short-term cushioning.

Moreover, the solvency capital requirement at individual level gives rise to a significant influence on decision-making in respect of investments, in light of the differences in capital requirements according to the investment category. From a macro-economic viewpoint, pro-cyclical effects and systemic instability are reinforced by the fact that there is incentive to make similar investments, hence less diversification of investment strategies and the emergence of “herd behaviour”. The increased solvency capital requirement will possibly, in times of crisis, lead to sales of assets at lower prices in order to ensure sufficient coverage of eligible capital, which will accelerate the drop in prices (so-called “fire sales”) thereby transforming “fictional” losses into actual losses.

To summarize all this, one can say that the structure of the solvency capital requirement according to Solvency II is not adequate for occupational pension schemes. It gives rise to excessive and economically unjustified capital requirements. Long-term liabilities often reduce risks – a fact that has quite simply not been taken into account under Solvency II. All this, finally, leads us to wonder to what extent the regulatory perspectives of Solvency II and Basel II are really adapted to occupational pension institutions, taking into account these essential differences.

12 It should be added that today it is not even necessary to provision the total amount at current values of the future benefits impacted by the occurrence of the risk. There is clearly a longer reaction time to build up this capital without involving a risk of insolvency for an occupational pension institution.
Due to the increased own funds requirements (irrespective of the fact that they are recorded directly with pension institutions by means of requirements similar to Solvency II or through the HBS with employers), this fundamentally raises the question of the future of occupational pension schemes in their current form. The expenses falling to employers as the sponsors of occupational pension provision would increase and this would lead employers to withdraw from occupational pension provision.

V. Conclusion – Vote for an autonomous regulation concept of occupational pension institutions instead of transposing Solvency II by means of the Holistic Balance Sheet

In conclusion, one can say that if the basic idea of the own funds requirement in Solvency II was to protect institutions for occupational retirement provision from the occurrence of certain risks and exceptional events, occupational pension institutions are often already protected by the existence of security mechanisms and additional protection systems. If the idea is to make these mechanisms consistently measurable and comparable, as, in the view of EIOPA, the Holistic Balance Sheet intends to do, this would involve a huge additional cost and workload that will be excessive for many pension funds. Also, one can only expect relative precision regarding the quantification of existing guarantees.

This means that the Holistic Balance Sheet approach put forward by EIOPA is in fact not an appropriate instrument to properly take into account the significant specificities of institutions for occupational retirement provision. It is true that this is also related to problems specific to the HBS and its implementation. But the fundamental problem is that the HBS does not propose an autonomous prudential concept adapted to occupational pension provision, but instead relies heavily on the principles and capital requirements of Solvency II for insurance undertakings. And this regulation concept is - as is explained above at length - not suited to the field of occupational pension provision.

Dr. Roberto Crucolini, AKA
Introduction

Furtherance of professional mobility thanks to improved portability of supplementary pension rights has for a long time been on the European Commission agenda. The proposed directive of 20.10.2005 and it amended version of 9.10.2007 were intended to be significant milestones to reach this objective. Given that the legal situation at the time required such proposals to be adopted unanimously, which was impossible due to the opposition of certain countries, many thought that the topic would no longer be addressed in the future.

But, as the English proverb says, “there’s life in the old dog yet” and the lack of political initiative after 2007/2008 should not lead to the conclusion that the issue was abandoned by the Commission. In its work programme for 2012, it has announced that it will make proposals this year with regard to supplementary pension rights for mobile workers. The Commission expands on that in the annex to its work programme, in which, referring to the above-mentioned directive proposals of 2005 and 2007, it explicitly states that it wishes to settle the issue of vesting of rights. In the draft White Paper on pensions leaked at the end of 2011, the Commission also announces that during the year 2012, it intends to present an amended version of the portability directive fixing minimum standards with respect to accrual and preservation of dormant supplementary pension rights. The same topic was also at the heart of the discussions during the last Pensions Forum of the Commission at the end of October 2011.

The Commission will therefore present an amended version of the portability directive soon, in all likelihood during the 2nd semester of 2012. Five years after the publication of the last directive proposal, the issue of portability will again be raised in discussions at European and national level. Against this backdrop, this article will propose a summary of past developments (section 1) and will explain the reasons for which the Commission intends to take up the subject again (section 2). This will be followed by a summary of the opinions defended by the Member States and the stakeholders (section 3) and closing remarks (section 4).

1. The portability directive – background

The efforts of the Commission to guarantee and improve the portability of supplementary pension rights date back to the 1990s. In a communication of 22.7.1991, the Commission already stated that workers should be able to be mobile within the Member States without being penalised in terms of their pensions. Although the rights accrued within the first pillar of the pension system have been governed for decades already by Regulation (EC) 1408/71 ensuring maintenance of the accrued rights in the event of professional mobility between different Member States, there is no similar regulation with respect to supplementary pension rights.

Directive EC 98/49 of 29.6.1998 on safeguarding the supplementary pension rights of employed and self-employed persons within the European Union was an intermediary step. The objective of this directive was to safeguard the rights of members of supplementary pension schemes moving from one Member State to another and thereby to contribute to removing obstacles to free movement within Europe. This directive does not, however, include any tangible provisions concerning cross-border transferability of occupational pension rights or minimum standards for accrual and preservation of dormant supplementary pension rights.
The Commission subsequently attempted to settle the issue of transferability of supplementary pension rights by means of dialogue with the European social partners. During a first consultation of the social partners in 2002, the need to further portability at European level was unanimously agreed upon. But one of the disputed issues was to decide whether this objective should be reached by means of secondary legislation or by means of a non-mandatory recommendation. In light of these divergent viewpoints among the social partners, the second consultation the following year did not give rise to any results and the Commission then proposed that the portability issue be settled by means of a directive.

On 20.10.2005, the European Commission presented the proposal for a directive on improving the portability of supplementary pension rights (COM (2005) 507 final) but, in compliance with the legal requirements of the time, it had to be adopted unanimously by all the Member States. The objective of the proposal was to remove the obstacles related to accrual of supplementary pension rights, to safeguarding of dormant pension rights and to the transfer of rights between Member States, but also within a single country. The objective of these measures was to improve the mobility of workers so as to make labour markets within the European Union more flexible.

This proposed directive covered all the supplementary pension schemes, excluding the statutory social security schemes. Fundamentally, the proposal did not include only provisions related to portability in itself, but also related to accrual of pension rights, for example by restricting vesting periods to a maximum of two years. The proposal also included rules for preservation of dormant supplementary pension rights of employees who have ceased their activity by means of a “fair adjustment”. As from this proposed directive, the term “portability” gained new significance in the European Union. It was no longer limited only to transferability in itself, but also addressed the issue of minimum standards in terms of accrual and preservation of dormant pension rights.

The proposed directive was subsequently an issue of great controversy. The bone of contention was above all the new regulations planned with respect to accrual of pension rights and preservation of dormant pension rights for employees who have ceased their activity. Even the mere application of a “fair adjustment” could – depending on its subsequent terms – lead to a significant increase in costs. Studies showed that a 1% increase both of dormant pension rights and of accrued pensions could, depending on conditions, generate excess costs that could reach up to 35%.

In light of these divergent views, the Commission published an amended proposal on 9.10.2007. Contrary to the initial version, this proposal no longer included a regulation on portability of rights because the Commission had followed the recommendation of the European Parliament in its opinion of 20.06.2007 aimed at cancelling the regulation on portability. The reason was that implementing compulsory portability would generate unbearable excess costs for certain supplementary pension schemes, which would almost certainly involve significant technical difficulties. The new proposal from the Commission was therefore restricted to regulations on accrual of pension rights and preservation of dormant pension rights, but the proposal was not adopted due to the refusal first of the Netherlands, and later of Germany and Luxembourg.

It was only a few years later that the Commission came back to the issue of portability in its Green Paper entitled “Towards adequate, sustainable and safe pension systems in Europe” of 7.7.2010, officially focusing on the theme of “mobility of workers and pensions” and coming to the conclusion that new impetus was needed to find a solution for all mobile workers. The ideas put forward by the Commission included, above and beyond the creation of a cross-border European pension fund for very mobile workers (researchers for example), the creation of tracking services to keep track of accrued pension rights. Finally, the Commission came back to its previous directive proposal by again taking up the discussion on portability and on the introduction of minimum standards for accrual...
and preservation of dormant supplementary pension rights.

2. A second chance for portability

The issues raised in the Green Paper do not in themselves explain the reasons that pushed the Commission to include the theme of portability in its work programme precisely at this point in time. The reasons probably lie in the opinions received by the Commission after the publication of the Green Paper (point a). Moreover, we should not underestimate the new provisions on legislative procedure set forth in the Lisbon Treaty stipulating that in the future a qualified majority is sufficient for adoption of a proposed directive, instead of the previously applicable unanimous vote requirement (point b).

a) The results of the consultation on the Green Paper

On 7.3.2011, the Commission published a summary of the replies received, including the opinion of the European Parliament. This summary paper aimed to reflect the diversity of the almost 1,700 replies received both from parties ranging from private individuals to the European Parliament, so as to have a general picture of the different opinions and thereby provide support to the Commission to better focus future legislative initiatives. Concerning portability, most opinions expressed were against regulation of portability and were more in favour of implementation of minimum standards. The reasons for refusal of portability were mostly related to technical and legal problems that had already led the Commission to abandon the idea of transferability of accrued occupational pension rights in the past, in its second proposal for a directive on portability. Concerning the creation of minimum standards, respondents mostly asked that there be enough time to adapt benefit plans and consequently, that concrete implementation of the said standards take place only slowly.

This opinion was quite widely shared by the European Parliament which asked the Commission to focus its future initiatives at EU level on the creation of minimum standards for accrual and preservation of accrued occupational pension rights. Concerning transferability, the Parliament considered that this could be achieved only by means of a present value transfer following a change of employer to a pension institution (second or third pillar). The opinion, however, does not provide any further details.

Given that this position was shared by the majority of respondents to the Green Paper, the Commission considered that it had enough backing to again take up the revised version of the proposed directive of 2007. But this general opinion alone would not be sufficient to allow the Commission to successfully implement its proposal. It also needs to obtain the required majorities, which had been impossible in 2007 due to the veto of certain Member States. With respect to this issue, the legal situation had evolved due to the new regulations set forth in the Lisbon Treaty as described hereinafter.

b) The legislative procedure after ratification of the Lisbon Treaty

The Lisbon Treaty that entered into force on 1.12.2009 gave European primary legislation a new contractual basis, namely the Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU). The TEU consists mainly of the general principles of the European Union, including, among others, the principle of subsidiarity and the principle of proportionality (art. 5 TEU).

The future initiatives of the Commission will be strongly impacted by the new provisions on legislative procedure in the EU. In compliance with article 289 in connection with article 294 of the TFEU, the European legislative procedure now as a rule follows the path of ordinary legislative procedure. After a transitional period until 2014/2017, the Treaty sets forth a qualified majority in the Council of 55% of the Member States representing at least 65% of the population of the European Union. In compensation, art. 12 paragraph b) of the TEU in connection with Protocol no. 1 on the roles of national Parliaments within the European Union provides that national parliaments ensure that a direc-
tive proposal made by the Commission is consistent with the principle of subsidiarity. If within the framework of an ordinary legislative procedure a simple majority of national parliaments expresses doubts on compliance with the principle of subsidiarity, the Commission is required to re-examine its proposal and to substantiate compliance if it chooses to maintain its proposal. If the doubts persist, the Commission must withdraw its proposal in the event of a qualified majority of 55% in the Council and a simple majority in Parliament.

Given that the legal bases of a future portability directive will be art. 114 of the TFEU and art. 46 of the TFEU (free movement of workers), the directive will necessarily have to be adopted within the framework of an ordinary legislative procedure. The former unanimous vote principle, which prevented adoption of the initial proposal, will be abandoned. In the future, votes against a proposal cast by only a few Member States will no longer be enough to prevent entry into force.

3. Position of the Member States and of the Stakeholders

Some Member States have recently expressed their support for a new proposal for a portability directive - albeit with a few reservations. These reservations essentially concern the differences that exist between supplementary pension schemes in the different countries, compliance with the principle of subsidiarity, the role of the social partners and preservation of existing systems. Against this backdrop, some ideas have been expressed aimed, for example, at restricting the amended portability directive to fundamental principles with applicability in time for the future. The idea of creating tracking services to keep track of accrued pension rights, however, appears to have reached a consensus as shown, for example, by the fact that this type of online service already exists in Sweden (www.minpension.se).

The situation is somewhat different concerning many stakeholders in the field of occupational pensions. A number of them have expressed critical viewpoints, based mainly on the following issues:

- Doubts as to the necessity for a directive in light of the still limited number of workers who move to another Member State to start a new job.
- Risk of increased costs following the introduction of EU-wide standards for accrual and preservation of dormant pension rights. This could in particular deter employers from implementing supplementary pension systems or lead to a reduction in the level of benefits of existing systems. A cost-benefit analysis upstream therefore appears to be essential.
- Contradiction with the text of the preamble of the Commission to the Green Paper of July 2010 stating that the Member States and the social partners are and would continue to be ultimately responsible for definition of the concrete terms of the (supplementary) pension systems, a viewpoint broadly shared by the majority of respondents to the Green Paper, including the European Parliament.
- Perpetuation of the prerogative of the social partners who, owing to their joint employer-employee representation, are the most qualified to defend the interests of both employers and workers through negotiation, even with respect to supplementary pension schemes negotiated by collective agreement.
- Difficulties in achieving harmonisation in light of the as yet unsolved issue of classification of “supplementary” pensions (or even of the 2nd pillar) in the 27 Member States.
- Introduction of new rules at EU level applying only to new contracts and not to already existing contracts.

4. Conclusion

The amended version of the portability directive will presumably be a key concern for the expert community as from the second semester of 2012. We do not yet know its exact content, but recent discussions lead us to believe that there is a good chance that the proposed directive will set forth
standards for accrual and preservation of dormant supplementary pension rights. It remains to be seen whether the social partners will keep as much room for manoeuvre as in the previous proposal of October 2007. Similarly, the issue of whether the Commission will again take up the theme of portability remains to be seen. Moreover, it is possible that the Commission will take into account the idea of a tracking service to keep track of accrued pension rights. In light of the diversity of pension systems in the different Member States, this will in all likelihood give rise to problems related to practical implementation.

Hagen Hügelschäffer, EAPSPI / AKA

---

**OCCUPATIONAL PENSIONS IN EUROPE – PENSION SECURITY THROUGH DIVERSITY AND AWARENESS**

On 14 October 2011, a seminar about the role and importance of occupational pensions as catalyst for pension security took place in Bilbao as part of the 25th anniversary celebration of Elkarkidetza. After the preliminary speeches of Elkarkidetza’s and EAPSPI’s representatives as well as of Bilbao’s Mayor, there were two panels. In the first one was composed of speakers from other European countries who provided input for the later discussion within the second panel that consisted exclusively of Spanish representatives.

In the first panel, presentations were made by representatives from APG (The Netherlands), KPA (Sweden), AKA (Germany) and CDC (France). All speakers presented the organisation of the different pension systems in the four countries. All of them are arranged around the usual three pillars system with the exception of France, where the first pillar is divided in two sub-pillars, one of them being complementary (compulsory) and the other one being supplementary (non-compulsory). The presentations are downloadable from EAPSPI’s website www.eapspi.eu / Events.

As a result of the speeches, some ideas could be extracted that could be seen as reasonable for a sound pension system model:

1. Three-pillar based schemes.
2. First pillar: PAYG with universal coverage.
4. Third pillar: Voluntary and personal. Insurance companies and banks.

In the second panel, three Spanish politicians – Isabel López i Chamosa (PSOE – Spanish Socialist Party), Tomás Burgos (PP – Spanish Conservative Party) and Emilio Olabarria (EAJ-PNV – Basque Nationalist Party) – introduced the ideas of their different political parties in terms of pension systems and retirement policies, though in a moderate version due to the proximity of the Spanish general elections. The three speakers are members of the Toledo’s Pact commission, the consultative instrument used by the Spanish parliament in order to implement and/or face any reform in the Spanish pension system.

This second panel was moderated by Mr Pedro Luís Uriarte, former Basque government minister and Vice-president, as well as former BBVA bank CEO. Mr Uriarte’s presence was especially interesting due to the fact that during his time in political office the EPSV law was passed, a law he drew up and followed during the legislative process. Under this regulation Elkarkidetza was created, as were the rest of the Basque EPSV, and it could be one
of the reasons explaining the relatively widespread implementation of the second pillar pension system in the Basque country compared to Spain. In his final speech, Mr Uriarte managed to sum up the different presentations made in both panels and at the same time gave some personal ideas about the characteristics of any sound pension system from the point of view of an external (in relation to the political parties and Elkarkidetza) person:

1. Pensions are a fivefold issue:
   a. It is important in relation to the economy, businesses and, most important, to people.
   b. It is critical, and when cited it is seen as an expert issue. It affects everybody at a global and at a personal level.
   c. The issue is subject to discussion: Different persons, political parties, stakeholders have very different points of view on the subject.
   d. The subject is present in current day-to-day life: Economic crisis, demographics...
   e. Pensions are a very complex issue, challenging to explain, hard to understand and difficult to accept, especially in Spain: Spain is the world’s fourth oldest country in demographic terms, and U.N. estimates place it in second place for the year 2050; the Basque demographic position is even worse.

2. The Spanish PAYG public pension system was expected to become bankrupt in the medium term according to a study published in 1980. Some of the reasons, which helped avoiding bankruptcy, were the economic boom that led to 13 years of economic growth at an annual rate of 3.5% - ending up in low unemployment rates -, the increasing participation of women in the labour market, and the big immigration inflows that Spain received.

3. At the moment of the seminar, the situation had inverted: Spain is under an extremely serious economic crisis that may take its economy 6 or 7 years backwards, only 3 years in the case of the Basque Country. The Spanish economy will not be able to create new net employment - according to IMF studies - before 2017. Therefore there will be no more new contributors before that date. Contributions have dropped drastically due to the rocketing unemployment ratio. World economic growth will stem from developing countries, locations with very weak - if any - economic relations with Spain.

4. Thus, there is a gloomy outlook for the Spanish public pension system: Problems are shared with the rest of the European countries though the Spanish situation is one of the worst at a European scale. A solution seen as a must is the - always mentioned though never accomplished - implementation of a voluntary and complementary second pillar pension system. In the Basque Country it already represents 30% of the Basque GDP, a relatively high figure if compared to the Spanish 8%, though really low if compared with the 75% European average.

5. In Spanish terms, the public pension replacement rate for an € 18,000 salary was mentioned to be necessarily around 100%; for a € 40,000 salary would be 66%, therefore needing accumulated reserves of € 240,000 in order to generate an adequate pension complement, obtained by annual contributions of € 2,300 if started at the age of 35, or € 5,500 if started at the age of 45, or € 16,000 if started at the age of 55, this latter case being financially unfeasible.

6. A big mistake would be to privatise the public sector pension system: It needs to maintain its public character in order to guarantee a minimum standard of living for the general citizenship. But the public system needs to be reformed in order to guarantee the pensions of future generations, basically with the help of second pillar pension system working together with the universal public first pillar. It is usually said that the economic situation does not leave margin for such a reform, but such a reform has already been made in a similar situation, in the Basque Country at a time of the deep 1980’s economic crisis, with unemployment peaks of 40% and with terrorism spread over the country.
7. The future of public pensions and Social Security are issues that should worry us, but in order to act and solve those worries, we should avoid useless political debates that do not add any rewarding output.

8. Second pillar pensions offer great advantages over third pillar individual systems: Lower management fees and annuities instead of lump sums, the latter not seen as real retirement products.

Aitor Emaldi, Elkarkidetza

THE EUROPEAN COURT OF JUSTICE CONDEMNS DIFFERENT TREATMENT OF THE INSURED PERSONS ON THE BASIS OF THEIR SEX

On 1 March 2011, the Court of Justice of the European Union ruled on a case brought by the “Association Belge des Consommateurs Test-Achats ASBL and Others” before the Belgian Constitutional Court, in reply to the question formulated by its Advocate General, Juliane Kokott of Germany, as to whether it is “compatible with the fundamental rights of the European Union to take the sex of the insured person into account as a risk factor in the formulation of private insurance contracts” (C – 236/09).

The case challenged the existence of a rule in Belgian legislation, taken from the European legislation, leading to different treatment on the basis of the sex for car insurance contracts: insurance agencies offer women lower premiums than men, because of they are statistically less likely to have a car accident.

The Court of Justice, referring to the principles included in the EU’s Charter of Fundamental Rights, which explicitly “prohibit any discrimination on ground of sex and require equality between men and women to be ensured in all areas” and, considering that Article 5(2) of Council Directive 2004/113/EC of December 2004 allows insurance agencies to differentiate premiums on the basis of the sex of the insured person, contrary to the principle of equal treatment between men and women and to the Charter, ruled as follow: “Article 5(2) of Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services is invalid with effect from 21 December 2012”.

This Directive, approved by the Council in 2004 to implement in the Member States the principle of equal treatment between women and men in access to and supply of goods and services, applies to matters of individual insurance plans unrelated to the labour market (the so-called third pillar). Article 5(2) provides for a possibility of a decision before 2007 to derogate from the principle of equal treatment until a review in 2012. The EU’s Member States have made use of this derogation for some or all insurance contracts.

On receiving news of the judgment, EU Justice Commissioner Viviane Reding, who is in charge of gender equality at the European Commission, declared: “Today is an important moment for gender equality in the European Union. Thirty years ago, the Supreme Court of the United States ruled that the Civil Rights Act of 1964 prohibits different treatment of insured persons on the basis of their sex in connection with pension funds. Today, the EU’s Court of Justice ruled that different insurance premiums for women and men constitute sex discrimination and are not compatible with the EU’s Charter of Fundamental Rights. Member States are not allowed to derogate from this important principle in their national legislation. The relevant
“opt out” clause in the Council’s 2004 Directive on gender equality is thus illegal”.

The provision condemned in the Court’s judgment is the controversial Article 5(2) of the Directive 2004/113/EC: “Member States may decide before 21 December 2007 to permit proportionate differences in individual’s premiums and benefits where the use of sex is a determining factor in the assessment of risk based on relevant and accurate actuarial and statistical data”.


The Belgian Constitutional Court, considering that the case called into question the validity of a provision Community law, decided to stay proceedings and on 29 June 2009 it referred the matter to the European Court of justice.

In its judgment, the European Court of Justice examined the question in the light of European Union law; in particular: Articles 2, 3 (2) and 13 (1) of European Community Treaty, Article 6 of European Union Treaty, Articles 21 and 23 of the Charter of Fundamental Rights. The Directive provides for a transitional period before entry into force, that is useful to allow insurance sector to adapt to the new rules and applicable to all new contracts concluded after 21 December 2007 (Article 5 (1)). The following paragraph (Article 5(2)) – that had been not included in the original text proposed by the Commission – introduces the exemption from its implementation: it was sufficient for the Member State to notify the Commission before 21 December 2007 – as in the Belgian case – and to publish and regularly update accurate data relevant to the use of sex as a determining actuarial factor, for everything to remain as before. The Member State then had almost 5 years to reconsider its decision. As the Directive did not impose any time limits on the derogation, the risk was that the Member State would continue to apply it indefinitely.

Therefore, the judgment foresees the derogation from the rule of unisex premiums in Article 5 (2) of the Directive is invalid with effect from 21 December 2012.

It is possible to establish a link between the Directive 2004/113 and another Directive approved in 2006, the Directive 2006/54/EC, which was designed to consolidate provisions on the implementation of equal opportunities and equal treatment between men and women in matters of occupation and employment, and so touches on pension funds of second pillar.

In fact, Article 9 of the Directive 2006/54/EC, at paragraph 1, lists rules opposed to the principle of equal treatment, including various forms of discriminations based directly or indirectly on the sex, such as (letter h) “setting different levels of benefits”. But, the rule’s text continues, saying “except in so far as may be necessary to take account of actuarial calculation factors which differ according to sex in the case of defined-contribution schemes; in the case of funded defined-benefit schemes, certain elements may be unequal where the inequality of the amounts results from the effects of the use of actuarial factors differing according to sex at the time when the scheme’s funding is implemented”.

The similarity between the exception foreseen in Article 9(1) h of the Directive 2006/54/EC and the derogation in Article 5 (2) of the Directive 2004/113/EC – which last March the Court of Justice ruled invalid with effect from December 2012 – is clear. In supplementary funded pension
schemes, premiums on the basis of the sex are normally different, because of the actuarial calculation on life expectancy. Instead, in basic pay-as-you-go schemes, there is a principle of solidarity between generations and sexes which takes the form of a unisex premium.

In the case of car insurance – as in the case brought by the Belgian Association – an advantage for women in comparison with men can be observed. Instead, in case of pension fund of the second or third pillars, women pay higher premiums, or receive lower benefits than men, because of they live longer than men. Regarding pension systems – that are private too, at least that are negotiated between the social partners – we might object that women’s “double presence” in labour market and in family care job, which means that women tend to have interrupted careers and earn less than men, is an argument in favour of the principle of solidarity between the sexes and the adoption of unisex premium. But, another fundamental argument was put forward when the project of what would become the Directive 2004/113 was presented: the existence of factors not related to sex, such as the socio-economic situation, the home environment and personal habits and conditions are just as important in determining personal life expectancy and render difference between sexes in life expectancy less important. Preliminary considerations of the Directive 2004/113 contain this kind of considerations, stating: “Differences in treatment may be accepted only if they are justified by a legitimate aim” and referring to, for instance, the protection of victims of sex-related violence, the promotion of gender equality, the freedom of association, of organization of sporting activities. And moreover declaring: “Certain categories of risks may vary between the sexes. In some cases, sex is one but not necessarily the only determining factor in the assessment of risk insured”. Therefore, it would be “inappropriate to link insurance risk to a person’s sex”, Advocate General Kokott affirms in her opinion on Case C – 236/09. The arguments deployed at the time by the EU Employment and Social Affairs Commissioner, Anna Diamantopolou, in support of her Directive, are the same that Test-Achats Association would present later, namely that statistical-actuarial criteria applied to the insurance matters produces a distortion of reality.

In Italy, the supplementary second-pillar pension scheme was introduced by the Legislative Decree No 124/1993. In supplementary funded pension schemes, there are no solidarity obligations as in public pension schemes. Social partners, trade-unions and enterprises, under the law, can choose to introduce in the preparatory agreements to the statutes of funds, provisions attributing specific qualities to beneficiaries and benefits. Therefore, pension funds may concern workers with temporary and permanent contracts; they may pay additional benefits such as those relating to premature death and invalidity; they may provide for the contributions of insured persons on maternity or paternity leave to be borne by the enterprises and calculated on the whole salary. The role of negotiation is thus decisive in introducing some elements of solidarity in a system that, otherwise and quite legally, would not have any. Most of the statutes of Italian pension funds have one or more of these qualifying factors. But, no fund among those set up after the Legislative Decree No 124/1993, refers to a calculation of benefits based on a unisex premium.

In 2010, the Legislative Decree No 5/2010 was adopted to implement the Directive 2006/54/EC, in Italy. Article 1 (2) of this Decree contains the derogation provided for in Article 9 (1) h of the European Directive, confirming the tendency to differentiate premiums on the basis of sex also in Italy. The Italian interpretation of the Community Directive is shared by most European countries. But, if it is true that the European Court of Justice, by its judgment of last March, censured any kind of discriminatory treatment on the basis of the sex, denouncing the derogation in the European Directive referred to individual insurance contracts; all the more, the rule in Directive 2006/54/EC regarding occupational pension funds should be considered to be in conflict with the principle of equal opportunities and equal treatment between women and men. Especially given the special nature of pension saving, which makes it different from any other form of insurance saving.

Elena Marisol Brandolini