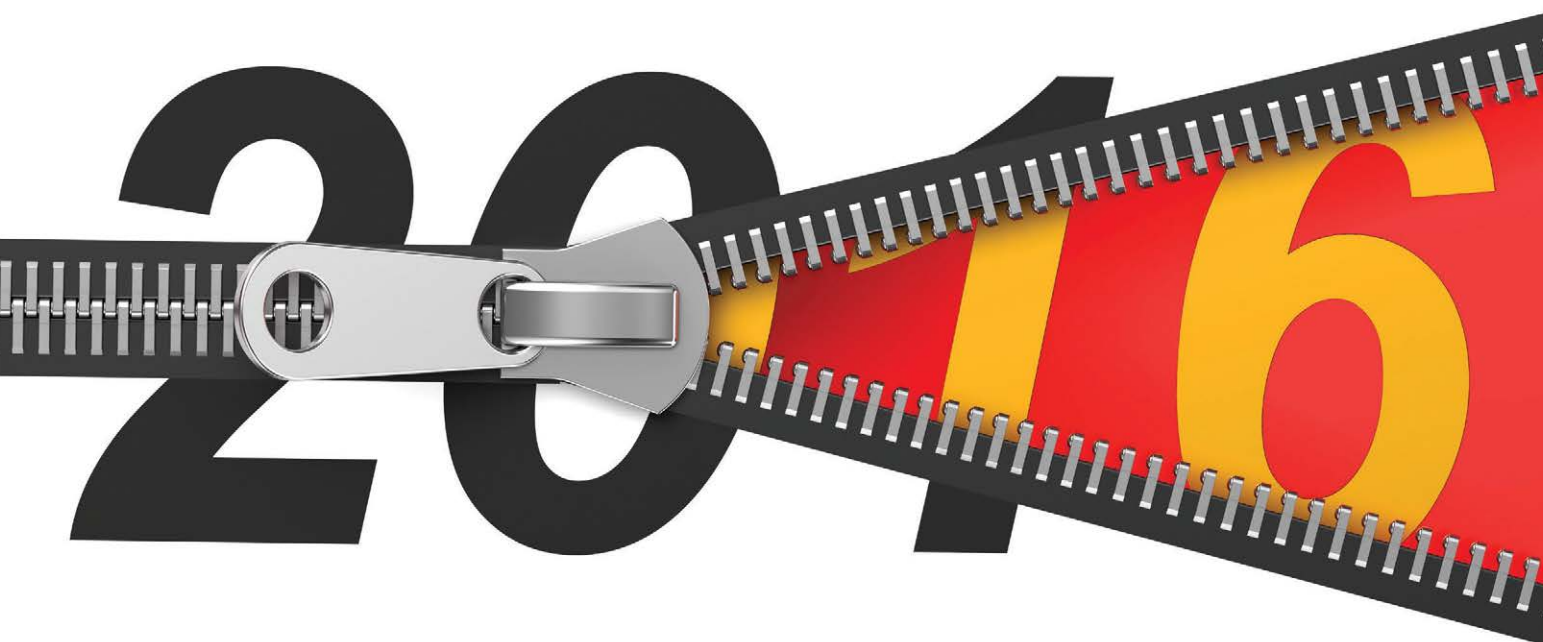


OVERVIEW

2016 and all that

Edmund Tirbutt explores what this year could have in store for European pension funds and the impact of political risk

WRITTEN BY EDMUND TIRBUTT, A FREELANCE JOURNALIST



The fact that the likely introduction this year of the revision of the Institutions for Occupational Retirement Provision Directive (IORP II) is being heralded as a broadly positive development is surely proof enough of the sense of pessimism elsewhere within the European pensions community, particularly regarding the ominous outlook for investment markets.

Regulation and legislation

Having to implement the risk reporting and, to a lesser extent, benefit reporting requirements of the directive will involve significant expense at a time when pension schemes are working hard to reduce

THE EUROPEAN COMMISSION'S STAFF HAVE INDICATED TO US THAT THE HOLISTIC BALANCE SHEET DOESN'T FIT IN WITH ITS POLITICAL AGENDA, AND IT'S FAIRLY CLEAR THAT IT WON'T BE FEATURING

costs. Nevertheless, individual member states are likely to have two years to implement IORP II from the time it is published in the Official Journal of the European Union, and they will enjoy much more room for manoeuvre when doing so than was the case with the original proposals.

Further reasons to be cheerful are to be found in the fact that the Pillar I solvency proposals have been thrown out for the time being, meaning that the directive applies only to governance and communications, and in the news that the European Insurance and Occupational Pensions Authority's (EIOPA) unpopular holistic balance sheet is unlikely to be included.

**A STABILISING OF LIFE
EXPECTANCY INCREASES
COULD BODE WELL
FOR THOSE MANAGING
PENSION SCHEME
LIABILITIES THIS YEAR**



Pensions and Lifetime Savings Association policy lead EU and international James Walsh says: “The European Commission’s staff have indicated to us that the holistic balance sheet doesn’t fit in with its political agenda, and it’s fairly clear that it won’t be featuring. I am expecting IORP II to be implemented this spring or summer.

“The amendments being made to it in recent months by the European Parliament are roughly speaking broadly similar to those already made by the European Council. The overall gist is that they have been simplifying the original European Commission proposals and making them much more practical and workable.”

PensionsEurope chief executive Matti Leppälä agrees the revisions by the Council and Parliament have been very positive but he is still concerned that the directive in its current form requires full funding at all times for cross-border schemes.

“We feel this hinders cross-border provision as there are very few cross-border schemes in Europe,”

he states. “We have pointed out that if you want more of them the cross-border funding requirement should be lifted but we are not optimistic about the outcome. Otherwise IORP II is good.

“We’ve all along recognised that good governance and good disclosure are very important, especially as the move from defined benefit to defined contribution schemes makes transparency more important, as members must have the risks disclosed to them adequately.”

Investment and life expectancy

Reasons to be cheerful away from the legislative front include the news that an interest in riskier investment strategies is unlikely to get out of control as pension funds continue to grapple with the implications of a low interest rate and low growth environment.

The Organisation for Economic Co-operation and Development (OECD) principal administrator for private pensions Emmy Labovitch says: “Given that interest rates could stay low for a long time,

over the past year we have been monitoring whether there could be an excessive search for yield.”

However, he emphasised that “we haven’t seen any general pattern yet in this respect”.

Architas chief investment officer Caspar Rock feels that a stabilising of life expectancy increases could bode well for those managing pension scheme liabilities this year.

“Life expectancy in the early part of this decade consistently rose by approximately three months a year but for the last four years we have experienced a low or negative improvement. There is no guarantee, but people are observing that this could ease cost pressures,” he comments.

LCP partner Alex Waite, on the other hand, feels a lot of pension schemes throughout Europe are “still deluding themselves we are all going to die at 85” and reports that many pension fund managers received “a nasty shock” in December 2015 when Switzerland issued its five year review of longevity. But he also emphasises

that bulk annuities are likely to become better value as a result of the insurance market recovering from the impact of having to implement Solvency II, and points out that this has already been happening in the Netherlands.

“If you need to get rid of the longevity risk you need to get someone to take it off your hands, and insurers are always willing to take it if the pension fund is realistic about the liability. This year we will see an increase in liability transfers to insurers as more and more pension funds get realistic about longevity across Europe,” he says.

De-risking, fiduciary management and upping contributions

Zurich Insurance global head of corporate life and pensions Hanno Mijer also singles out the de-risking of longevity exposure as being one of the main themes of 2016.

He states: “To date many of the de-risking solutions have focused on the larger funds with the capacity to engage the many specialists needed to plan and deliver complex bespoke solutions. This year will see this tool become more common amongst mid-sized and smaller pension funds as more off-the-shelf solutions are provided.

“These may be buyouts, buy-ins or swaps, but the common theme will be straightforward transactions to pass longevity risk to insurers or reinsurers who are better able to manage the exposure. We know the pension fund appetite to solve this longevity issue is high as we have seen unprecedented demand for solutions from the UK, Ireland and elsewhere.”

Away from the investment climate, IORP II and de-risking, there is little overlap between commentators regarding what they consider to be the main issues

for 2016.

Lincoln Pensions head Darren Redmayne expects fiduciary management work to be to the fore this year.

“I expect pension funds to award fiduciary mandates, especially in the case of defined benefit schemes where a fiduciary manager may be better placed to respond to volatility than trustees that meet quarterly, or possibly even monthly for larger schemes.”

Punter Southall International head Julia Whittle feels the key theme for 2016 is the need for employers to realise the importance of

THIS YEAR WILL SEE THIS TOOL BECOME MORE COMMON AMONGST MID-SIZED AND SMALLER PENSION FUNDS AS MORE OFF-THE-SHELF SOLUTIONS ARE PROVIDED

contributing more to pensions.

She says: “The Dutch have been on the front foot with their defined benefit schemes, and others will start to realise how important the issue is. The UK, in particular, is severely lagging behind and, when they move offices to the UK, the majority of European employers are amongst the highest contributors to UK pension schemes.”

Willis Towers Watson international consulting group director David Finn singles out engaging with members as likely to be more in focus this year, pointing out that best practice has gradually been improving in previous years. This engagement will start from encouraging employees to join the scheme, with

the emphasis on explaining what the scheme provides and their long-term importance, as well as ongoing understanding of investment choices, the lead into retirement, and the form to take benefits in at retirement.

“There’s a lot of focus on different modelling tools to help with ongoing investment decisions, asset allocation decisions and how much to save. We are getting an increasing number of requests in this area,” he comments.

Cardano head of innovation Stefan Lundbergh observes that the populists are gaining ground in the political arena in all countries and fears that if any were to get in at elections this year it could have consequences for pensions because “funded pensions are an easy target to raid for those wanting to do populist reforms”.

However, once one strays into the area of political risk there are a number of other issues that seem even more frightening still. As yet there seems no hint of a solution to the problems posed by mass immigration or by the so-called Islamic State. Brexit could also occur in 2016, and rumblings in North Korea could assume a whole new dimension. The potential knock-on effects to the investment climate resulting from any of these issues are certainly frightening. ■