Pension Fund Crisis Management
The Response from the Regulators

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Oxford, Corpus Christi College, September 27th 2012
PGGM, Niels Kortleve
Dutch (European) pension under pressure

LONGEVITY

Liabilities: €800 bn.
Contributions: €25 bn.

MARKET

BOND YIELDS

AGEING
Current Dutch pension deal: dual focus
New deal: soft real benefits OR nominal guarantee

Current contract
Indexation ambition: Risk full investments AND nom. ‘guarantee’

No hard nominal guarantee
Risky investments thus risk of benefits cuts

“Do what you say”
Nominal guarantee
1) Expensive
2) Wrong certainty
3) Not sustainable?

“Say what you do”
Real ambition
Focus on indexation
Downside: possibly benefit cuts
Defined Ambition preserves collectivity and risk sharing

Collective

Individual

No Risk sharing

Maximal Risk sharing

- Targets real (indexed) benefits
- No hard guarantees
- No fixed retirement age
- Stabilised contribution
- Explicit deal on risk sharing
EIOPA proposes Holistic Balance Sheet

**Assets**
- Sponsor covenant + PPS (Component 7)
- Financial contingent assets (Component 6)
- Financial assets (Component 5)

**Liabilities**
- Excess of assets over liabilities (Component 3)
- Risk buffer (Component 2)
- Best estimate of liabilities (Component 1)
- Capital requirements (SCR and MCR) (Component 4)

**Technical provisions**

Component that may or not exist

Component that always exists

Traditional balance sheet

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
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<tbody>
<tr>
<td>Bonds 78</td>
<td>Liabilities 100</td>
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<tr>
<td>Equity 52</td>
<td>Surplus 30</td>
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Assets 130
Liabilities 100

Funding ratio 130%

Illustrative figures only
Traditional balance sheet with SCR

- SCR of 20% (60/40 mix)
- Free surplus of 10:
  30 (original surplus) – 20 (SCR)

Illustrative figures only
Holistic Balance Sheet with extra contributions in case of underfunding

Assets

- Bonds 78
- Equity 52
- Possible contribution increase 7

Liabilities

- Liabilities 100
- Surplus 20
- SCR 17

- Extra contribution in case of underfunding: present value of 7
- Extra contributions absorb part of shocks: SCR decreases slightly
  - Contribution increases have some loss absorbing capacity
- Free surplus increases with 10
  - 7 in conditional assets
  - 3 because of lower SCR

Illustrative figures only
Holistic Balance Sheet with complete contract

- No SCR needed if all shocks absorbed with contingent assets and liabilities
- No free surplus

*Illustrative figures only*
Holistic Balance Sheet with complete contract AFTER shock

- Drop in assets would lead to increase in contingent assets and ‘lowering conditional liabilities’ and decrease in ‘increasing conditional liabilities’
- Still no SCR and free surplus

Illustrative figures only
Holistic Balance Sheet with complete contract before and after shock

- **Assets**
- **Liabilities**

**Before shock**

- Contingent assets
- Increasing conditional liabilities
- Lowering conditional liabilities

**After shock**

- Contingent assets
- Increasing conditional liabilities
- Lowering conditional liabilities

Illustrative figures only
Suggestions for better regulation

EC seems to target one QIS until proposal for IORP II
EIOPA and stakeholders want more QISses
- No copy/paste Solvency II, time for developing new concepts
- Complex valuation and calculation (see next sheet)
- Including consequences for contributions, pensions and investment behaviour IORPs
- QIS should be KISS (Keep It Short and Simple); one QIS can not give all relevant information
- Still unclear how to use HBS in prudential supervision
Benefit steering – like in Defined Ambition – should be included
- SCR=0 if (contingent) assets and liabilities absorb all shocks
## Holistic balance sheet: advantages and challenges

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Challenges</th>
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<tr>
<td>Steering mechanisms explicitly valued</td>
<td>Complex valuation</td>
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<tr>
<td>Enhanced comparison between contracts</td>
<td>• Incomplete markets</td>
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<td>Increased discipline</td>
<td>• Assessment of sponsor risk</td>
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<td>Improved transparency</td>
<td>• Big influence PBO horizon</td>
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<td>• Valuation of discretionary power</td>
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<td>Requires complete pension deal: lower degrees freedom</td>
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<td></td>
<td>Pseudo security</td>
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<td>Proportionality</td>
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