Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II		Deadline 31 July 2012 18:00 CET
Name of Company:	BASF SE	
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Reference	Comment	
General Comment	We welcome the initiative of EIOPA to perform quantitative impact assessments, since this will contribute to a better transparency related to the review of the IORP directive and avoid unintended adverse consequences. Furthermore, we welcome the opportunity to provide our comments to this consultation. However, we have many concerns with regard to the content and the underlying process: 1. We question the necessity to review the IORP-directive. Occupational pension markets are related to national social security systems as to their structure and benefit level. Synergies from investing pension assets can and currently are – even on a global basis – already exploited even if the IORPs of a group remain separate and are not merged in one single-pan-European pension fund. 2. The EU Commission announced several times that “any new supervisory system for IORPs should not undermine the supply or the cost-efficiency of	

	occupational retirement provision in the EU." It does not require an over-engineered QIS to reach the conclusion that solvency II-like capital requirements based on December 2011 yield levels will drastically increase the capital requirements and therefore reduce the supply or the cost-efficiency of the occupational retirement provision in the EU. 3. By means of the HBS (Holistic Balance Sheet), EIOPA made a proposal for a harmonised quantitative risk-based supervisory framework. We believe that in practice this proposal would overburden IORPs as well as the national supervisory authorities. There are significant differences between pension systems in the EU, such as the form of the pension promise, the security level (based on SLL (Social and Labour Law) requirements, among others), involvement of social partners etc. As a consequence, such differences make it very difficult to introduce one harmonised "one size fits all" supervisory framework for different pension systems. Furthermore, trying to take as many differences as possible into consideration would create insurmountable complexity for IORPs and the supervisory authorities. We are of the opinion that the responsibility for setting the detailed rules for supervision of IORPs should remain at the Member State	

	level. Since IORPs provide pensions subject to SLL and because the pensions provided by them are meant to supplement social security pension benefits, harmonisation of rules should be left to Member States. In addition, security levels vary widely across Europe, since pensions offered by IORPs are based on a wide dispersion of state pensions (first pillar) and fiscal treatments. Harmonisation cannot be achieved without simultaneously harmonising SSL and first pillar pensions, a step that is so far considered undesirable by most or all European parties. 4. The IORP review will have a major impact on occupational pensions in Europe. Against this background, we consider the time schedule as completely inadequate for a careful consideration of the complex issues raised in this consultation. Solvency II framework has been in development over 10 years and has taken five QIS exercises so far. Nevertheless, the impact of Solvency II on long-term guarantees is still under discussion. The issues for IORP are at least as complex as for insurance companies. EIOPA should advise the EU Commission that additional Quantitative Impact Studies will be necessary in order to fully evaluate the impact of a new regulatory framework for IORPs.	

	5. Furthermore, we believe that the EU Commission exceeds its competencies by adopting the holistic balance sheet approach to IORPs: • Legal limits to measures of the EU follow from the fact that the organisation of the pension systems falls into the primary field of competence of the Member States. In this respect, the power of the Member States to organise the pension systems also comprises their financing basis. Therefore, an amendment to the IORP-Directive based on Art. 53 para. 1, Art. 62 and Art. 114 TFEU must not significantly affect the financial equilibrium of IORPs organised under national law. • The limits to the use of competences imposed on the EU point in the same direction: With regard to the principle of subsidiarity it has to be noted that activities at the level of the Union can only be taken and justified if they lead to additional value beyond the IORP supervision at member state level. However we cannot see how Solvency II would result in added value. In contrast, we fear that it would destroy the current structures for occupational pensions in the member states. In addition, given the variety of structures of the IORPs in the	

member states, a self-consistent system of rules cannot be achieved by detailed EU-wide regulatory framework as long as an exact interlocking of the European set of rules with each individual national system – therefore, also with the different national security mechanisms for the protection of the persons entitled to retirement benefits – does not take place.

6. Finally, we would like to emphasize that the Solvency II Directive should not be the starting point of any modification of the IORP Directive, since there exist essential differences between IORPs and insurance companies:
   - IORPs have a social dimension providing occupational pension schemes that match the 1st pillar pensions which on their own prove not to be sufficient to secure old age income.
   - IORPs are a means to provide remuneration to the employees for their service with the sponsoring companies and, in addition, a means of the company’s social policy towards its employees. Therefore, IORPs do not provide products that are sold on the private third pillar insurance market. Therefore, IORPs have a different internal logic than market-driven selling of insurance

	products. • IORPs – mostly – are not-for-profit institutions – they do not have to remunerate shareholders, • Occupational schemes provide a wider coverage, especially through collective agreements, as opposed to individual voluntary solutions. Such industry-wide pension schemes tend to be administered by IORPs. • Other IORPs have no or very few staff members and the sponsor(s) rely on corporate personnel to manage the scheme. There is evidence that IORPs are characterized by great efficiency and by low internal costs, in particular due to the fact that almost all the employees in a given company or sector are covered. In view of the sustainability and affordability of occupational schemes, these characteristics should not be put at risk. • IORPs are funding vehicles where the interests of the scheme's board/management are broadly aligned with the scheme members and beneficiaries. There is generally no conflict over the pursuit of a profit by the scheme at the expense of its members and	

	beneficiaries. • The governance structure of IORPs is characterized by the involvement of social partners, the role of trustees (and/or persons carrying out similar fiduciary responsibilities) and the backing of the employer. • Solidarity is often a further core element of occupational pension schemes. Members' contributions are mostly calculated regardless of the age, gender and specific occupational risks. A further element of solidarity is the compulsory participation that prevents participants from leaving the scheme as is the case with individual and voluntary solutions. • IORPs have specific built-in security mechanisms that ensure the benefit security of pension schemes. Some pension schemes allow contributions from the sponsor and main benefit parameters to be modified by the employers and the employees' representatives. • For DB- and hybrid DB/DC schemes, in at least some Member States, employers have the ultimate responsibility for fulfilling the pension promise. A very important aspect is the long-term	

	investment perspective of IORPs since they administer solely pensions. Therefore, long-term developments are more important than the short-term distortions that have to be considered under the Solvency II regime.	
Q1.	**Do stakeholders agree with the general set-up of the QIS exercise as put forward in the Introduction (Chapter 1)? What improvements do stakeholders suggest?** We disagree with the general set-up of the QIS exercise for the following reasons: • The methodology for IORP-QIS fully adopts the methodology of Solvency II. The Technical Standards for IORPs are largely just "copy/paste" from the Technical Specifications for QIS 5 which has been prepared for insurance companies. Risk-based capital requirements under Solvency II rely on short-term market based parameters and are therefore inherently volatile as well as pro-cyclical and will endanger the stability and long-term sustainability of IORPs. Furthermore, the underlying principles of Solvency II and consequently the Holistic Balance Sheet are based on full market valuation and a Value at Risk (VaR) methodology. The experience over the last years shows that there	

	are some second thoughts – by both scientist and practitioners – if this kind of models should be still applicable. • The valuation for technical provisions on a market-consistent basis does not fit the business model of IORPs, whose pension promises are untradable, neither by the IORP-members, who are generally unable to surrender or cancel their promises, nor by other market participants, since IORPs are not selling promises to other insurers, in whole or in part. Transfers of individual contracts or small portfolios are the exception not the rule, and are subject to review in each individual case by the national supervisory authority, a review which extends to the IORP's ability to meet its obligations and the impact on existing contracts. Considering that there is no "market" for pension contracts held by IORPs, any valuation of those contracts based on the fair value method would be, at least initially, a purely artificial exercise with no practical relevance. Because of the limited tradability described above, pension promises are held by IORP-members to the end of the duration ("held to maturity"). Considering any accounting standard, assets with similar characteristics (loans) are not measured based on (volatile) fair value. Hence, IORPs should also be measured in accordance with the inherent logic of their technical business	

	plan. • EIOPA should not stick to the Solvency II approach and rather examine alternatives to the HBS such as Asset Liability Management Studies or stress tests. • Supervisors and IORPs have up to now no or at least very limited experience with the concept and the valuation of the HBS. The technical specifications are too complex for a first QIS and will overburden most IORPs, leading them not to take part in the QIS. This is especially the case, since the time schedule of the consultation and the QIS are too tight. The stakeholders need more time in order to adequately comment on the technical standards. If there will be only one QIS as scheduled by the Commission, then definitely not all relevant questions can be addressed and answered. Due to the high complexity, the costs required to run such a complex QIS will be very high. We believe that EIOPA should start with a very simple first QIS focussing on those variables that will explain 80% of the impact (e.g., interest rate). Analysing these results would clearly prove that the methodology of Solvency II and the HBS does not fit the business model of IORPs.	

Q2.	**Do stakeholders believe that the adjustment (discretionary and conditional benefits, last resort benefit reductions) and security mechanisms (sponsor support, pension protection schemes) IORPs dispose of are taken into account adequately?** We welcome that EIOPA explicitly recognizes the specifics of IORPs with regard to additional adjustment and security mechanisms. However, we think that the adjustment and security mechanisms are not adequately taken into account. First, we believe that EIOPA pursues a wrong approach by taking Solvency II as a starting point and striving to incorporate the specifics of IORPs into the Solvency II framework. Even after over 10 years in development and five QIS exercises the Solvency II framework is still under controversial discussion due to the inconsistency with long term guaranties and because it is still unclear which unintended side-effects Solvency II regulation will have in the functioning of the capital markets. Sponsor support and PPS (Pension Protection Scheme) are very complex elements that were not considered under Solvency II. We believe that much more study is required to accurately assess these mechanisms.	

	Finally, the calculation models for adjustment and security mechanisms require complex techniques like stochastic simulations and option price models and are especially not practical for multi-employer IORPs, which are often among the largest IORPs.	
Q3.	**Do stakeholders believe that the draft technical specifications provide enough information and are sufficiently clear and understandable? Which parts could be improved upon?** IORPs and consultants of the pension industry have no experience in the Solvency II framework – particularly with the valuation of the adjustment and security mechanisms. The evaluation of adjustment and security mechanisms requires complex techniques (stochastic simulations and option price models). Given the fact that this is the first QIS, we believe that the technical specifications are too complex and will make many IORPs to decide not to take part in the QIS. Furthermore, numbers generated in the QIS when applying the HBS approach will be based on an accumulation of many assumptions. Consequently, we doubt that the HBS will provide reliable information about the schemes' "real" funding situation.	

Q4.	**Do stakeholders believe that the calculations proposed in the technical specifications are feasible at appropriate costs and with appropriate accuracy within the given timeframe of the QIS?** The calculations proposed in the technical specifications are neither feasible at appropriate costs nor with appropriate accuracy within the given timeframe of the QIS. As stated in answer to Question 3 above, IORPs and consultants of the pension industry have no experience in the Solvency II framework. In order to calculate the Holistic Balance Sheet, many assumptions have to be made and many data have to be gathered by IORPs. Since the impact of a small change in the assumptions can have a large impact on the outcome, because the sensitivity to some assumptions is high, different interpretations of the technical specifications will lead to completely different and therefore unreliable results. Against this background, we think that the costs of the QIS cannot be justified given the expected reliability of the outcomes. To draw a first picture of the impact of the HBS on IORPs, EIOPA should focus on main drivers of the quantitative impact: the discount rate and the duration of	

	liabilities. Analysing these variables will be straightforward and will explain 80% of the impact.	
Q5.	**Do stakeholders believe that the draft technical specifications provide enough guidance on how to set up and value the holistic balance sheet as discussed in Chapter 2? If not, which parts could be improved upon and in what way?** As discussed in the answer to Question 4, it requires a lot of interpretation in order to calculate the steering and adjustments mechanisms. This will lead to large differences in the answers and consequently to unreliable results. For multi-employer schemes, the HBS is not feasible since it requires the value of each (or most relevant) employer's support for the scheme.	
Q6.	**Given the purpose of the QIS, do stakeholders consider the proposed simplifications for the valuation of the holistic balance sheet (for the risk margin in section 2.5, sponsor support and pension protection schemes in 2.6 and amounts recoverable from insurance in 2.7) adequate? Do you have suggestions for additional simplifications that would be appropriate?**	

	More simplifications are desirable (given the purpose of this QIS). EIOPA should advise the EU Commission to start with a very simple QIS and gradually decide during the next QIS on where more sophistication is needed. In addition, we reject the proposal of an inclusion of implicit or explicit risk margin or buffers as part of technical provisions. The concept of cost of capital is not appropriate for IORPs (see answer to Q 1).	
Q7.	**The best estimate of technical provisions should be based on the most recent mortality tables including the future trend in mortality rates (Section 2.4). Do stakeholders believe that IORPs will be able to take into account this trend in mortality rates? Can you explain?** In Germany it is already common practice to calculate the technical provisions of IORPs using mortality tables which include mortality trends. However, besides our general critique on the intention of the EU Commission to apply the Solvency II framework to IORPs, we believe that suitable mortality trends should be defined on a national level since they depend heavily on the population covered by the	

	IORP.	
Q8.	**Is it clear enough from the technical specifications what cash flows should be taken into account in the calculation of the best estimate (e.g. in relation to benefits (unconditional, pure conditional, pure discretionary, mixed), contributions, expenses, etc.) and how the projection of these cash flows should be made (Section 2.4)?** It is not clear which cash flows should be taken into account in calculating the best estimate of technical provisions. In particular, the definitions of conditional, discretionary and mixed benefits as well as the distinction between ex post and ex ante benefit reductions are unclear. Furthermore, in order to quantify the conditional benefits a stochastic approach may be required. Consequently, quantifying the conditional benefits will be very burdensome and expensive.	
Q9.	**EIOPA is considering to take into account in the QIS the possibility in some member states to reduce benefits in case of sponsor default (for example, when a pension protection scheme does not guarantee the full level of benefits) in the valuation of the best estimate of technical provisions (see Reduction of benefits in case of sponsor default in Section 2.4 and Pension**	

	protection schemes in Section 2.6). Do stakeholders agree and, if yes, should it only apply in case of sponsor support backed up by a pension protection scheme or to sponsor support in general? We agree that all steering mechanisms of IORPs (such as for example the possibility of reducing benefits) should be taken into account in the regulatory framework. However, we believe that the HBS is not the right approach for doing this, because we do not believe that it is possible to develop for all specifics of IORPs a “one size fits all” approach.	
Q10.	**The technical specifications propose that security mechanisms should be valued on a market consistent basis, i.e. by calculating the probability-weighted average of (discounted) expected payments from the sponsor and the pension protection scheme (Section 2.6). Do stakeholders agree with the principles for the valuation of sponsor support and pension protection schemes? If not, what alternatives would you propose?** No. In its proposal EIOPA is striving to ascribe “market consistent” values to concepts that are in practice difficult if not impossible to quantify. Trying to do this	

	leads to calculations that are far too complex and burdensome. Furthermore, we consider that the evaluation of the security mechanisms is too much assumption-driven. This makes the outcome very sensitive to any slight modification of the underlying assumptions. Against this background, we believe that the costs of calculating the values of the security mechanisms are not justified by the reliability of the results. Moreover, the input data required are not available in many cases. For example, EBTDA is a figure that is usually only published with respect to publicly-listed companies. In addition, it will be also impossible to value the sponsor of multi-employer plans – particularly in the case when the sponsor consists of many SMEs. Besides this, we think that especially in cases where there is a sponsor support or a pension protection scheme, no calculations are required. These security mechanisms should be treated as a residual asset that fills the deficit shortfall between assets and liabilities including any capital requirement. However, being limited by EIOPA on three options within the Holistic Balance Sheet Approach to take into account for pension protection schemes, we believe	

	that pension protection schemes should be explicitly considered in the HBS as a separate asset.	
Q11.	**Do stakeholders have suggestions for the parameters - such as the probability of default and the recovery rate in the event of default - used in the valuation of sponsor support and pension protection schemes (Section 2.6)?** As already mentioned, we believe that the HBS and the market consistent valuation of the security mechanisms is not the right approach for “not for profit” IORPs. Additionally, the valuation of the sponsor support and the pension protection scheme is very complex and will overburden most IORPs.	
Q12.	**Do stakeholders agree with the methodology set out to value the maximum value of sponsor support (Section 2.6)? Do stakeholders have suggestions for the parameters used in valuing the maximum amount of sponsor support? In particular, with regard to the proportions of future profits / EBTDA and the time period of the calculations.**	

	We welcome the proposal of EIOPA that all steering mechanisms of IORPs should be explicitly taken into account in the regulatory framework. However, we think that the sponsor support is not adequately taken into account. EIOPA pursues a wrong approach by taking Solvency II as a starting point and striving to incorporate the specifics of IORPs into the Solvency II framework. Furthermore, the maximum value of the sponsor support is based on an accumulation of many assumptions (for example, arbitrarily determined thresholds for sponsor company's own funds, net profits and EBTDA as well as long-term forecasts for future financial conditions of the sponsor company). This makes the outcome very sensitive to any slight modification of the underlying assumptions.	
Q13.	**The draft technical specifications propose performing an upward shift in the basic risk free interest rate curve to approximate the so called counter cyclical premium or to allow IORPs – under conditions – to apply the so called matching premium (Section 2.8). Do stakeholders agree with this approach to take into account the long-term nature of pension liabilities?**	

	We welcome all measures that better take the long-term nature of pension liabilities into account. However, shifting the yield curve by 50 basis points will have only a very little impact and does not adequately take into account the long-term nature of pension liabilities. The valuation for technical provisions on a market-consistent basis does not fit the business model of IORPs and will lead to volatile and pro-cyclical results. Furthermore, given that the Holistic Balance Sheet approach is based on Solvency II which in turn relies on the capital adequacy framework for the banking industry, we fear that the convergence of behaviour influencing regulation will increase the risk to the financial system and the wider economy (for example, in crises situations effects on capital markets will be pro-cyclically accelerated).	
Q14.	**Do stakeholders agree that the proposed way to derive the level B discount rate adequately reflect the expected return on assets of IORPs (Section 2.8)? If not, what alternative would you propose?** We endorse EIOPA's proposal to valuate pension liabilities using a "Level B" discount rate based on the expected return. However, we have some concerns regarding the way to derive the level B discount rate for fixed income investments. The yield for fixed income investments consists	

	of an average yield of government bonds, corporate bonds and bonds issued by banks. Other fixed-income investments are not considered. In Germany many IORPs have significant investments in covered bonds that have to be included when deriving a level B discount rate.	
Q15.	**Do stakeholders agree that the draft technical specifications specify a fixed yearly percentage of respectively 2% and 3% for the expected inflation rate and salary growth? Or should IORPs also be allowed to expected inflation implied by financial markets? Could you explain?** We believe that the expected inflation rate should be derived by using long-term historical values. With regard to the salary growth we do not believe that it is appropriate to determine a standard rate. The salary growth must refer to the type and nature of the workplace.	
Q16.	**Do stakeholders believe that the description of the SCR in Chapter 3 is sufficiently clear and understandable to enable participants in the QIS to perform the necessary calculations?**	

	We are very concerned that the SCR proposals are directly copied from Solvency II technical specifications. Furthermore, as described above we think that risk-based capital requirements according to Solvency II do not fit the business model of IORPs as they rely on short-term market based parameters and are therefore volatile as well as pro-cyclical. This will endanger the stability and long-term sustainability of IORPs.	
Q17.	**Do stakeholders believe that the risks IORPs are facing are adequately reflected in the calculation of the SCR and MCR (Chapter 3 and 4)? Are there in the stakeholders' view any risks being considered that are not material and could be excluded from the technical specifications? Are there other risks that should be considered in the calculation of the SCR?** As discussed in the answer to Question 16, we think that risk-based capital requirements according to Solvency II do not fit the business model of IORPs. Additionally, several risks included in the SCR are less relevant for IORPs (e.g., catastrophe risk, health risks, lapse risks etc.) and therefore unnecessarily complicate the model.	
Q18.	**Do stakeholders believe that the way the loss-absorbing capacity of**	

	adjustment mechanisms and security mechanisms is taken into account in the calculation of the SCR (Section 3.2) is adequate? We welcome that EIOPA recognises the loss-absorbing capacity of IORPs' adjustment mechanisms and security mechanisms. However, given the fact that the Holistic Balance Sheet is basically Solvency II with some additional, supplementary adjustments for IORPs, we do not agree with EIOPA's approach to adopt the Holistic Balance Sheet to IORPs.	
Q19.	**Do stakeholders believe that the calculation of SCR in the Operational risk module (Section 3.3) is adequate for IORPs?** In Germany, on the basis of statutory subsidiary liability, employers are also liable for operational risks of the IORP. Against this background, it is not understandable why operational risks are not covered by the loss-absorbing capacity of the sponsor support. Furthermore, the special governance structure of IORPs and "not-for-profit" nature of IORPs are not adequately taken into account in the calculation of operational	

	risks.	
Q20.	**Do stakeholders believe that the simplifications provided for the calculation of the SCR (for spread risk on bonds in section 3.5, value of collateral in section 3.6 and mortality, longevity, benefit option and catastrophe risk in section 3.7) are adequate? Do stakeholders have any concrete suggestions for additional simplifications?** As discussed in the answer to Question 16, we think that risk-based capital requirements according to Solvency II do not fit the business model of IORPs.	
Q21.	**Do stakeholders believe that the treatment of sponsor default risk in the counterparty default risk module of the SCR calculation (Section 3.6) is appropriate? If not, what improvements would stakeholders suggest?** The treatment of sponsor default risk is not sufficiently clear. In particular, it is absolutely unclear how the sponsor default risk should be valued for multi-employer plans.	
Q22.	**Do stakeholders believe that the calculation of SCR in the Benefit option risk**	

	sub-module (Section 3.7) is adequate for IORPs? These risks are either non-existent or immaterial for IORPs.	
Q23.	**Do stakeholders believe that the descriptions of financial and insurance risk mitigation (Section 3.9 and 3.10) are sufficiently clear and understandable to enable participants in the QIS to perform the necessary calculations?** No. Besides our concerns regarding the basic approach underlying the holistic balance sheet approach, we think that the criteria and the descriptions of financial and insurance risk mitigation are not sufficiently clear and understandable for IORPs.	