

Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II		Deadline 31 July 2012 18:00 CET
Name of Company:	Balfour Beatty plc	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ Do not change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇒ Leave the last column <u>empty</u>. ⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a paragraph or a cell, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. <p>Please send the completed template, <u>in Word Format</u>, to CP-12-003@eiopa.europa.eu. Our IT tool does not allow processing of any other formats.</p> <p>The numbering of the paragraphs refers to Consultation Paper 12-003.</p>		
Reference	Comment	
General Comment	<p>We are surprised and disappointed by the complexity and rigidity of the QIS technical specification, which falls far short of including the "appropriate changes to reflect the nature of IORPs" that the Commission had led us to expect. Whilst we welcome the decision to consult on the technical specification, we also regret that, once again, the timescale for consulting is unrealistically short given the importance and complexity of the subject .</p> <p>We are very concerned that the scope of the QIS consultation, in its focus on the technical construction of the Holistic Balance Sheet, gives insufficient weight to the hugely important issue of the supervisory regime surrounding the proposed requirements. This is absolutely critical,</p>	

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because it will determine the impact on IORPs and their sponsors, and hence also on jobs, investment behaviours, systemic risk and the impact on future pension provision and national budgets. No quantitative impact assessment can be complete without significant work in this area, including a consultation. IORPs cannot be expected to articulate their own responses to the new requirements until they know the regulatory regime that will surround it.

As a further general point, we feel very strongly that the approach reflected in the QIS consultation is inconsistent with the situation that the UK occupational pension sector finds itself in. Pension provision, and defined benefit occupation pension provision in particular, is in serious decline and this issue is highly likely to have serious economic and social consequences in the decades ahead. Most DB liabilities are ‘legacy’ in nature, in that they relate mainly to past periods of employment and members who have no current relationship to the sponsor. We believe that a sense of balance has been lost between protecting the accrued rights of past generations of employees and providing the environment that encourages greater pension provision for the current and future generations of employees. However well-intentioned, the imposition of a much more onerous solvency regime for IORPs risks making this situation much worse. The result will be to exacerbate the inter-generational inequalities that are already emerging in pension provision, and to raise the risk of serious economic and social outcomes.

The QIS technical specification appears to us to involve calculations that are far too complex for all but the largest IORPs.

We are concerned about the SCR as a particular example of an area of the proposals that does not recognise the current situation of UK IORPs. The majority of UK IORPs are ‘closed’ to new entrants and ‘on a journey’ to settlement – through the final discharge of their remaining liabilities by buying out with one or more insurers. Unlike insurance companies, UK IORPs do not exist to transact business for profit. As soon as they reach the level of funding at which they could pass their liabilities to the insurance market, they will do so. Sponsors are, in general, funding the shortfalls in their pension plans as quickly as they can reasonably afford. The SCR appears therefore to be of only theoretical relevance to members and sponsors, as it would have no

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	<p>impact on the sponsor’s actions or on the level of security for IORP members. A highly complex calculation then for no practical purpose.</p>	
<p>Q1.</p>	<p><i>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?</i></p> <p>Our general comments above raise a number of concerns about the general scope and set-up of the QIS. In particular, we cannot conclude that the QIS specification is ‘fit for purpose’ without clarity about the regulatory actions that would accompany any change to the solvency regime for IORPs.</p> <p>What will the consequence be if the HBS does not balance (ie assets do not cover liabilities, taking into account all security mechanisms)? UK IORPs cannot raise additional capital other than from sponsor support, which would not improve the HBS. Unless there are positive actions that can flow from consideration of the HBS, without adverse consequences for jobs, growth and investment markets, then we do not see the merit in imposing a complex and costly regulatory regime.</p> <p>The proposed calculations are very complex, with multiple iterations such as calculating the SCR three times: gross, net of the loss-absorbing capacity of security mechanisms, and net of the loss-absorbing capacity of technical provisions. It is unlikely that many IORPs will have the ability or resource to carry out the QIS process sufficiently accurately to adequately inform responses to this consultation. We also doubt that many (if any) IORPs will currently have data to the required level of detail to be able to carry out these calculations. It follows that supervisory authorities will also lack these detailed data.</p>	
<p>Q2.</p>	<p><i>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?</i></p> <p>In our view, the issue of valuing ‘sponsor support’ needs more thought. In particular, it is by no means uncommon for an IORP to have a ‘single’ sponsor, but that sponsor could be one of a</p>	

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	<p>group of associated undertakings. Moreover, within a group environment there may be several IORPs sponsored by various entities within the group. It is also quite common for these group entities to be dispersed across the EEA and beyond. Within groups there may be explicit or implicit cross-entity guarantees. All these facets need to be assessed in placing a value on sponsor support.</p> <p>Furthermore, the proposed approach to valuing sponsor support seems technically complex and precise, and we would argue that this is spurious accuracy given the subjective judgements that are being made. For example, arbitrarily determined variables are applied in a number of critical points, such as the 50% recovery rate (HBS 6.17); the assessment of future profits and sponsors' earnings (HBS 6.36); the proportion of shareholder funds available for the IORP; the 50 bp adjustment to allow for the illiquidity premium (HBS 8.12); the inflation and salary increase assumptions (HBS 8.23 and 8.24, respectively); the mortality and longevity shocks of 15% and 20 % (SCR 7.17 and 7.29, respectively) and the figures in the counter-party default risk module (amongst others)..</p> <p>The timescale for the consultation exercise has not allowed adequate consideration of possible alternatives.</p>	
Q3.	<p><i>Do stakeholders believe that the draft technical specifications provide enough information and are sufficiently clear and understandable? Which parts could be improved upon?</i></p> <p>We consider that the technical specification is far too complex to be widely understood.</p>	
Q4.	<p><i>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?</i></p> <p>No. not at all.</p> <p>We are very concerned that the approximate methods that must inevitably be adopted for the QIS risk materially understating both the results and the resources required to provide results</p>	

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	under the new regime as implied by the QIS specification. In relation to the SCR, significant resource will be needed to assess this yet, in the UK environment, the presence of the SCR appears to be of little practical benefit.	
Q5.		
Q6.		
Q7.	<p><i>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?</i></p> <p>We consider the reference to the most recent tables to be ambiguous. If it is intended that “recent tables” refers to the most recent calibration of the IORP to standard tables, we are happy to support this principle. If, by contrast, it is intended to require IORPs to calibrate their mortality only by reference to the most recently published standard tables, we would consider this a retrograde step. IORPs should be permitted to use the standard tables that best fit their demographic profile even if that means calibrating to older tables.</p> <p>We consider “future trend” to be an unsatisfactory term, and in the context of HBS 4.2 note that no recently published mortality tables in the UK include a future trend. However we would support the principle of using mortality tables that included a “best estimate” projection of future mortality improvements.</p>	
Q8.		
Q9.		
Q10.	<p><i>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?</i></p> <p>Our concerns are that a number of the central parameters provided seem arbitrary and that this is likely to compromise the objective of market consistency. In addition, there is room for very</p>	

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	<p>different interpretations of the parameters, such as the expected future profits, which again seems to militate against the aim of market consistency.. We also reiterate the point that the complexity of the arrangements and corporate inter-relationships through which sponsor support is provided to IORPs militate against a formulaic approach to the assessment of sponsor support.</p> <p>.</p>	
Q11.	<p><i>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)?</i></p> <p>We understand that the ECON has recently advised in its statement of 19 June 2012 that “no EU law would be permitted to refer to credit rating for regulatory purposes, and regulated financial institutions would not be permitted to sell assets automatically in the event of a downgrade” – so it is evident that EIOPA will have to amend this proposal.</p> <p>From a purely technical view, there may be different ratings given to a sponsor by different rating agencies. In particular, there may be some rating agencies whose ratings of the sponsor are out-dated or non-existent. Furthermore, credit ratings are not necessarily a reliable guide to the probability of default on a sponsor’s pension obligations.</p> <p>The issue discussed in response to question 2 above, regarding treatment of sponsors within a group of associated undertakings and with links to cross-border and non-EEA entities, also applies here. It seems reasonable when assessing the strength of sponsor support to consider the position in the event that that sponsor becomes insolvent. However, it is evident that a lot more thought is needed as to how to go about this – on the basis that use of credit ratings is inappropriate. Looking at the issue of groups of undertakings and cross-jurisdictional issues, it is evident that to take this into account in a formulaic but fair way will be complex and hence both time-consuming and expensive . For example, past experience suggests that the value of sponsor support can alter significantly over relatively short timescales and due to factors that may not be quantifiable until after the event</p> <p>.</p>	
Q12.	<p><i>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</i></p>	

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	<p><i>maximum amount of sponsor support? In particular, with regard to the proportions of future profits / EBTDA and the time period of the calculations.</i></p> <p>On a specific aspect, we do not understand why the parameter for the proportion of shareholder funds available for the IORP should be limited to 50% in determining the maximum value of sponsor support.</p>	
Q13.	<p><i>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?</i></p> <p>We consider that EIOPA should consider all the options for taking into account the long-term nature of pension liabilities.</p>	
Q14.	<p><i>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?</i></p> <p>We commend the principle of including this approach for determining the discount rate. Indeed ,we would very much like to see this approach developed so that it can become the primary method for determining the technical provisions. By doing so, IORPs will be encouraged to continue to develop a more diversified investment strategy, thereby reducing systemic risk in investment markets. We consider that IORPs are well placed to be able to invest in assets that support economic growth, business investment and jobs (including infra-structure projects and European ‘project bonds’).</p> <p>We would suggest that the proposed approach to derive the level B discount rates should be refined to take account of the range of investment strategies available to IORPs. .</p>	
Q15.	<p><i>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?</i></p>	

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	<p>The fixing of these variables is in stark contrast to the highly-detailed approach adopted in other areas of the specification in the name of achieving market consistency. It is unclear why IORPs are not required to set their inflation assumption in a market-consistent way.</p> <p>We are also strongly of the view that salary growth should only be allowed for to the extent that future salary-linkage is guaranteed (and cannot be limited or terminated by the IORP or sponsor).</p>	
Q16.		
Q17.		
Q18.	<p><i>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?</i></p> <p>We are concerned that this approach which requires three different SCR calculations is complex and will be expensive.</p>	
Q19.		
Q20.		
Q21.		
Q22.		
Q23.		