

Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II		Deadline 31 July 2012 18:00 CET
Name of Company:	European Federation for Retirement Provision (EFRP) Contact: Mr. Matti LEPPÄLÄ, Secretary General / CEO Koningsstraat 97 – 1000 Brussels – Tel. + 32 2 289 14 14 www.efrp.eu – efrp@efrp.eu	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	Comment	
General Comment	The European Federation for Retirement Provision (EFRP) welcomes the opportunity to comment on the Draft Technical Specifications for the EIOPA QIS. Summary:	

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	<ol style="list-style-type: none"> 1. The EFRP believes that the IORP Directive revision will not have the outcomes desired by the White Paper and the EU2020 strategy. It contains the risk doing the opposite, namely reduce the adequacy of pension provision, which is of concern since recent pension reforms have mostly focused on preserving the long-term sustainability of systems rather than pension adequacy. 2. The EFRP welcomes the fact that some of the unique characteristics of IORPs are taken into account in the Holistic Balance Sheet (HBS) approach; yet, the proposed HBS model will be an unworkable tool for IORP supervision due to the huge complexity and subjectivity of the chosen assumptions. Other models for IORP supervision should also be taken into consideration. 3. The QIS as it is proposed in the consultation document, is not sufficiently comprehensive to serve as a basis for a revised IORP Directive. It will be very hard for EIOPA to come up with an adequate advice due to the very tight timeframe of EIOPA. The EFRP asks the European Commission to provide more time to EIOPA. A coherent, detailed process free of time pressure is needed to come up with a suitable prudential framework for IORPs. <p>General remarks:</p> <p>1. IORP Dir. revision and the bigger picture: adequacy and coverage should be the aim The EFRP sees the revision of the IORP Directive as part of the broader pension reforms in the European Union, as envisaged in the White Paper - An Agenda for Adequate, Safe and Sustainable Pensions. Pension reforms in Member States generally put pressure on the 1st pillar pensions, so the 2nd and 3rd pillar pensions have to be the solution to address the adequacy of European pensions. However, the starting points in each Member State are different and the reforms are based on different approaches.</p> <p>The aim of the EFRP is that Member States and EU regulations make it easier, not harder, for companies to set up and develop workplace pensions. Indeed, we urge the EC to recognise the comprehensive pension reforms going on in the Member States: if the costs of workplace pension provision go up through the IORP Dir. revision, then the 1st pillar will have to carry more of the</p>	

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	<p>pension burden, but this is exactly the opposite of what the EU recommends. The QIS follows the Call for Advice and its results may end up in a revised IORP Directive. But the question is: <i>“Does the revision take priority over the general pension systems and their reforms?”</i></p> <p>The Commission has proposed that <i>“any new supervisory system for IORPs should not undermine the supply or the cost-efficiency of occupational retirement provision in the EU.”</i> The EFRP fully endorses this proposal and wants to highlight that in many Member States occupational pensions are voluntary benefits, that employers grant to their employees. IORPs are often organized by employees through collective bargaining and employers and are not-for-profit institutions. This implies that any solvency requirements, which will make IORPs more expensive for the employer or that will bind more of the employers’ capital that could be otherwise used for his operative businesses, will significantly reduce the attractiveness of the respective IORP for the employer. Employers may in future offer forms of occupational pensions that leave their employees with much more uncertainty than today or simply stop offering occupational pensions to their employees. After reading the proposed Technical Specification of the QIS, the EFRP is concerned that the revised IORP Directive might hamper the supply of cost-efficiency of occupational retirement provision.</p> <p>The proposed risk-based capital requirements and valuation with the risk-free interest rate, especially if based on a flawed definition of risk and short-term market based parameters, are inherently volatile as well as pro-cyclical and will endanger the stability and long-term sustainability of IORPs. Given that Solvency II is itself based on the capital adequacy framework for the banking industry, which has a very different business model to insurance, we fear that the convergence of behaviour influenced by regulation will increase the risk to the financial system and the wider economy.</p> <p>The proposed structure of the high solvency capital requirements for investments in risk-bearing capital provides a strong incentive for IORPs to invest in (risk-free) government bonds instead of equity, listed and non listed and alternative investments or in equity. This can not be desirable</p>	

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	<p>since IORPs should be able to remain important suppliers of capital to listed European companies, small and medium-sized enterprises (SMEs) as well as a great number of innovative start-ups. An SCR regime for IORPs could limit their investment opportunities. This will not only result in expected lower returns and thus expected lower pension benefits (or higher contributions), but also have a negative impact on growth and employment in the European Union. The proposed revision is therefore not in line with Europe 2020 Strategy and with the aim of having more long-term investments to improve the competitiveness of the European economy.</p> <p>Finally, the proposed complex model would force IORPs to spend many resources on financial and other services in order to build stochastic models, which would draw resources away from IORPs rather than flow into pension assets. Furthermore, the EFRP remains sceptical whether the IORP Directive revision process will result in more cross-border pension provision, which was one of the initial reasons for starting the revision process. We believe that the EC's focus should first and foremost be on stimulating supplementary workplace pension provision rather than on cross-border pension activities.</p> <p>We believe that EU efforts on workplace pensions should particularly focus on the great number of workers who are not covered by them, in order to contribute to pension adequacy for all European citizens.</p> <p>2. The Holistic Balance Sheet is an inappropriate tool for IORP supervision</p> <p>In its response to the Call for Advice, the EFRP welcomed the fact that the specific characteristics of IORPs will be taken into account in the revised IORP Directive. However, the proposed model of the Holistic Balance Sheet (HBS) is an unworkable tool for IORP supervision, due to the huge complexity and subjectivity of the assumptions chosen by authorities.</p> <p>The proposed QIS methodology does not address the most important question – how will the HBS be used in practice? If it is to replace the existing scheme-specific funding regime, then clarity is needed about what kind of recovery periods will be permitted. This would have a direct and very</p>	

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	<p>significant impact on pension schemes, employers, employees and the entire economy.</p> <p>The Technical Specifications of the proposed QIS show that a lot of different and subjective assumptions have to be made in order to calculate the HBS. This makes the HBS very sensitive to model risk: the accumulation of assumptions leads to an accumulation of insecurities. The EC's aim of making schemes comparable appears unfeasible.</p> <p>The EFRP therefore opposes the HBS model, as it is inappropriate as a supervisory tool to measure long term-liabilities and investment horizon by IORPs.</p> <p><i>No copy-paste of Solvency II?</i> A large part of the QIS consultation document seems to have been copy-pasted from the Solvency II Directive despite the European Commission's promises that the IORP revision would not be a copy-paste exercise. Those sections in the consultation document that are pension-specific (ie, not directly inspired by the Solvency II Directive) appear somewhat simplistic and require more consideration and a more sophisticated approach. For example, the importance of inflation risk is underestimated.</p> <p>3. The QIS consultation process The EFRP welcomes the opportunity to respond to the Consultation on the Technical Specifications for the Quantitative Impact Study. The EFRP regrets the very short timeframe in which stakeholders are asked to respond to this very technical consultation. We also regret to see that this first QIS is very detailed, which makes it hard for individual IORPs to provide responses. IORPs will be subject to the revised Directive and should therefore get the chance to study the technical specifications and submit their reactions.</p> <p>We believe that this QIS will not give all the necessary insights needed for a future IORP II directive. Before the European Commission makes a proposal for a new Directive, it should have an adequate overview of the possible answers/insights/numbers, impacts and the sensitivity to</p>	

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	<p>the different assumptions and options. Unfortunately, the proposed QIS does not make this possible. There is too little guidance on new items such as the valuation of steering and adjustment mechanisms and there are many different interpretations and subjective assumptions to be made. This makes the HBS very sensitive for model risk: the accumulation of assumptions leads to an accumulation of insecurities. Therefore, many different responses to the QIS will be possible and this makes the different QIS exercises not comparable.</p> <p>As some crucial elements in the prudential framework are still unknown (recovery periods, tiering of assets and liabilities), the real impact on pension contributions, employers and pension benefits cannot be calculated at this time. Furthermore, this prudential framework would have to be set up before the value of the different valuation and steering instruments can be determined.</p> <p>The EFRP is concerned about the process of running the QIS. In some Member States, the supervisors will respond to the QIS, with individual IORPs unable to respond. It will be more useful for EIOPA to receive feedback from IORPs and the qualitative questionnaire instead of supervisors or consultants. After all, when a new IORP Directive is adopted, it will be the IORPs themselves who will have to perform all the calculations. Before a proposal can be tabled, it should be clear that IORPs are able to do all the calculations, what the sensitivity of the different assumptions is and what the impact of the QIS will be on real IORPs. Overall, only eight or nine Member States will participate in the QIS. This raises the question of the legitimacy and representativity of the QIS. IORPs that will be subject to the new -very technical- rules will be unable to be involved in the process in some Member States.</p> <p>Performing this QIS will be very expensive for IORPs. This results in the risk that only big IORPS will have the resources to perform the QIS and present results. The sponsor of small IORPS could perceive this complexity as a sign for the future regulation for IORPs, that could be too burdensome. Unfortunately, the consequences of this process would be the closure of current occupational pension plans.</p>	

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	<p>Overall, the EFRP believes that if the EC wanted to obtain enough data within a short time to justify proposing a new IORP Directive, then this QIS will not achieve its objective. Equally, if EIOPA wanted to hold a general QIS to answer the question: “<i>Is the HBS a useful tool for supervisors?</i>”, then this objective has not been achieved either. The current QIS cannot answer all questions and is too hard for most single IORPs to answer. It is not an adequate follow-up to the CfA, and it is not enough to base the new IORP Directive on. Since the concept of the HBS and the valuation of the steering and adjustment mechanisms is completely new, all the practical difficulties cannot be addressed in one QIS; therefore, more QISs and further detailed analysis are needed in order to calibrate all parameters if an attempt is actually made to develop the HBS as a workable supervisory tool. More QISs will have the advantage that there could be an adequate process of interaction between supervisors, IORPs and other stakeholders in order to come-up with an appropriate supervisory tool.</p> <p><i>The EFRP has answered the 23 questions. However, the EFRP wants to highlight that this does not imply that the EFRP supports the methodology of a HBS approach as supervisory instruments for IORPs.</i></p>	
Q1.	<p>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?</p> <p>The EFRP does not agree with the general set-up of the QIS exercise. On the one hand, the QIS exercise is very exhaustive for a first impact study with a lot of very detailed calculations in a very short timeframe. Therefore, it is very questionable if IORPs could provide an adequate input to the QIS and that all the relevant issues can be tackled in one run. The time given to stakeholders for consultation is too short for adequate internal research. It is very important to have more time.</p> <p>On the other hand, the proposed QIS is not extensive enough. If the European Commission would only want to run one QIS before a proposal for a new IORP Directive, the Commission should have</p>	

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	<p>an adequate overview of the possible answers/insights/numbers and the sensitivity to the different assumptions and options. Unfortunately, this is not possible with the proposed QIS. There is too little guidance on new items such as the valuation of steering and adjustment mechanisms and there are many different interpretations and subjective assumptions to be made. This makes the HBS very sensitive for model risk: the accumulation of assumptions leads to an accumulation of insecurities. Therefore, many different responses to the QIS will be possible and this makes the different QIS exercises not comparable. The EFRP strongly recommends starting with a first simple QIS and gradually deciding on where more sophistication is needed in the next QISs (on Lamfalussy Level 1).</p> <p>Furthermore, there is a strong risk that pensions funds –especially the small ones- will not have enough time and resources to both reply to the EIOPA’s consultation and carry out the QIS. The sample of IORPs that will participate to the QIS process will therefore be biased.</p> <p>The QIS is not as representative as it should be. In some Member States, the supervisors will respond to the QIS, with individual IORPs unable to respond. It will be more useful for EIOPA to receive the feedback from IORPs and the qualitative questionnaire instead of supervisors or consultants. After all, when a new IORP Directive is adopted, it will be the IORPs themselves who will have to perform all the calculations. Before a proposal can be tabled, it should be clear that IORPs are able to do all the calculations, what the sensitivity of the different assumptions is and what the impact of the QIS will be on real IORPs. Overall, only eight or nine Member States will participate in the QIS.</p> <p>The EFRP regrets the absence of both qualitative questionnaire and spreadsheet that could have given stakeholders more insight about the QIS exercise.</p> <p>The EFRP regrets the strong similarities between the Solvency II QIS and the IORP QIS. Some provisions (especially those concerning the SCR) are a copy-paste from Solvency II QIS. These similarities between the two QISs raises some issues: for instance, the concept of risk margin that</p>	

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	<p>must be calculated according to the cost-of-capital formula and that is included in the calculation of the technical provisions, does not make sense for IORPs.</p> <p>The requirements for the proportional application of the rules are very complex themselves and the level of detail here seems to come too early in the process. The process of determining and applying proportionality could be as labour-intensive as doing the actual calculations.</p> <p>It is difficult to give feedback to EIOPA on all the different chosen parameters in the proposed Technical Specifications, because there is no explanation on how these parameters are derived at all.</p>	
Q2.	<p>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?</p> <p>We foresee that this QIS will not give all the necessary insights for a future IORP II directive. There is too little guidance on several items such as the valuation of steering and adjustment mechanisms, which are the unique characteristics of IORPs. The lack of clarity with respect to the valuation of the steering and adjustment mechanisms will lead to large differences in the answers. These are new elements in a supervisory framework, also compared to already existing supervisory frameworks. IORPs, consultants and supervisors have no experience with the valuation of a HBS. If the European Commission would like to have an adequate overview of the answers/insights/numbers in only one QIS, more guidance and more analysis are required.</p> <p>Especially more guidance will be desirable with respect to the stochastic analyses, because based on the current Technical Specifications it is very likely that there will be substantial differences in interpretation. Furthermore, the applicable prudential framework is still unknown (use of MCR, tiering of assets and liabilities, recovery periods). Because the prudential framework is still unknown, the real impact on pension contributions, employers and pension benefits cannot be calculated. These elements of a prudential framework will also determine the value of the</p>	

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	<p>different valuation and steering instruments.</p> <p>The calculation of conditional benefits presupposes stochastic models and this will be new, like supervisory framework.</p>	
Q3.	<p>Q3. Do stakeholders believe that the draft technical specifications provide enough information and are sufficiently clear and understandable? Which parts could be improved upon?</p> <p>There is a lot of information for a first QIS exercise and the timeline is too short to enable IORPs to digest all this information. There are many different and subjective assumptions to be made to calculate the HBS. This makes the HBS very sensitive to model risk: the accumulation of assumptions leads to an accumulation of insecurities.</p> <p>Some elements are not sufficiently clear:</p> <ul style="list-style-type: none"> • It is very difficult to value the liabilities and contingent assets: There is no market for long dated liabilities, for wage indexation and long dated volatility. • It is unclear how incomplete pension contracts/discretionary benefits should be valued • It is unclear how many years of use of steering instruments may be included. The more years of extra contributions, the lower the capital requirement <p>As already pointed out, the HBS requires complex (option) techniques and there is too little attention paid to them in the EIOPA' draft technical specifications. As a result, many interpretations and outcomes will be possible.</p> <p>The EFRP regrets the absence of both qualitative questionnaire and spreadsheet that could have given more insight to the stakeholders about the QIS exercise.</p>	

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	<p>We believe that a search for an appropriate model should be undertaken with input from industry and free from time pressure.</p>	
Q4.	<p>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?</p> <p>The costs are probably not justified given the expected reliability of the outputs. The QIS exercise will be expensive notably because it will imply an ALM-type study. The IORPs without such types of models are likely either to pay large fees to external consultants or avoid making the impact study (especially small IORPS, for which these costs would be too high).</p> <p>Furthermore, it is very questionable how useful all these expensive calculations will be: the outcome of the calculations will be a single figure, but the meaning of this figure could be devoid of meaning due to the complexity, the reliance on many assumptions and the very short timeframe for this QIS (especially since this is a new kind of evaluation). It will be the employers, employees and retirees who will have to pay the price for this expensive exercise.</p> <p>The EFRP has concerns with respect to the accuracy, because in some Member States the QIS will only be performed by national supervisors instead of real IORPs. If EIOPA and the European Commission want to know the real impact on IORPs, the QIS should also be performed by real IORPs. The use of aggregated data makes the comparison between funds and countries meaningless.</p> <p>Given the complexity, it would be recommendable to start with a simpler standard model and having more QISs before the European Commission makes its proposal, in order to examine whether the HBS approach is a workable tool.</p>	

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Q5.	<p>Q5. Do stakeholders believe that the draft technical specifications provide enough guidance on how to set up and value the HBS as discussed in Chapter 2? If not, which parts could be improved upon and in what way?</p> <p>The EFRP stresses that in many areas it is still rather vague how the HBS will have to be constructed. Many calculations are either complex or in case of suggested simplifications will not provide meaningful results. Moreover, models to apply the HBS will lead to increased costs for IORPs.</p> <p>Limited guidance is provided on how to value the steering and adjustment mechanisms, whereas these elements differentiate IORPs from insurance companies are relatively new compared to the well-developed Solvency II framework. For a detailed valuation of the steering and adjustment mechanisms a stochastic analysis is required. Guidance with respect to this valuation is missing, which will lead to large differences in the answers related to the same balance sheet items, both as a result of interpreting how and which options should be taken into account, the way these options should be calculated and the (different) simplifications that IORPs will use. Since so many choices can be made, the comparability of data will be difficult, even more so because EIOPA will not have an insight in the underlying calculations. The valuation of sponsor support is especially complex. Moreover, the current specifications are not designed for multi-employer IORPs, undertakings of multinationals and not-for-profit employers.</p> <p>Regarding market consistent valuation, the EFRP warns that it is likely that different organisations/approaches can come up with different results even though all are market consistent. Figures resulting from the QIS are very dependent on assumptions (in calibrating the model etc.) and could therefore be unreliable. The model risk could be quite severe.</p>	
Q6.	<p>Q6. Given the purpose of the QIS, do stakeholders consider the proposed simplifications for the valuation of the HBS (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</p>	

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	<p>suggestions for additional simplifications that would be appropriate?</p> <p>The EFRP welcomes simplifications, but wants to mention that further simplifications are warranted. Furthermore, extensive evidence and data are required before the simplified calculations can be performed. The proposed process to be applied before being able to perform the simplified calculations under the proportionality criteria is more demanding than doing the actual – more difficult - calculations. The costs involved in this will not spur the IORPs to use simplified calculations. A better process would have been to start with a simpler QIS and gradually decide whether more sophistication is needed in next QISs.</p> <p>The EFRP is very concerned about the relevance of the risk margin and its valuation. The valuation using the concept of cost-of-capital does not make sense for IORPs as it does for insurers. Moreover, the EFRP disagrees with the inclusion of the risk margin for adverse assumptions into the best estimate calculation. The purpose of the risk margin – to provide an extra buffer against risks over and above technical provisions – is duplicated by the Solvency Capital Requirement.</p> <p>Further simplifications in the valuation of sponsor support and pension protection schemes will contribute to a higher level of participation in the QIS exercise.</p> <p>The formulas for sponsor support cannot be used in many cases:</p> <ul style="list-style-type: none"> - Multi-employer fund - Subsidiaries of multinational companies - Not-for-profit employers <p>The EFRP is concerned about the reliance on credit ratings in the computations. There was a clear commitment by representatives at the G20 summit to reduce the reliance on credit ratings in financial regulation. This point has been taken up by the OECD in redrafting the Core Principles for Occupational Pension Regulation and the European Commission in its draft revision of the Credit Ratings Regulation. In October 2010, the Financial Stability Board also argued that the reliance on</p>	

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	<p>credit rating agencies should be reduced. They proposed that standard setters and authorities should assess references to credit rating agency ratings in standards, laws and regulations and, wherever possible, remove them or replace them by suitable alternative standards of creditworthiness. The ECON Committee of the European Parliament also emphasized this point recently: “no EU law will be permitted to refer to credit rating for regulatory purposes”. It should be noted that the vast majority of employers who sponsor occupational pensions are not rated.</p> <p>Alternative option : As a simplification for a first QIS, the sponsor support and/or the pension protection scheme could be treated as a residual asset that fills a deficit shortfall between assets and liabilities, including any capital requirements.</p>	
Q7.	<p>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?</p> <p>The EFRP agrees that the most recent mortality tables available to the individual IORPs should be used for the calculation of the best estimate. The providers of mortality tables must also be reputable.</p> <p>The trends on mortality tables should take into account the different life expectations for the populations of each Member State. The mortality tables defined as standard to each Member State should be accepted.</p> <p>It should be noted that in some Members States the introduction of these type of mortality tables will have a significant impact, because they are not commonly in use.</p>	
Q8.	<p>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</p>	

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	<p>conditional, pure discretionary, mixed), contributions, expenses, etc.) and how the projection of these cash flows should be made (Section 2.4)?</p> <p>The calculation of the cash flows in the HBS/QIS is unclear. In particular conditional cash flows are difficult to quantify through the three suggested methods in QIS specifications. In order to produce comparable information across countries, the instructions on how standard premiums, recovery premiums etc will have to be taken into account should be absolutely clear.</p> <p>We believe that too little guidance is provided to ensure some utility and comparability of the outputs. For example, more guidance is required for the following issues:</p> <ul style="list-style-type: none"> – When projected benefit obligations (PBO) should be taken into account. – Definitions of conditional, discretionary and mixed benefits are not clear and it is therefore hard to make a distinction between them. – How to deal with a pension promise where different parts offset each other and are funded via different pension vehicles? (eg. an employer funded DB plan, with an employee funded DC part where one part is managed by an IORP and the other by an insurance contract?) – Last resort benefit reductions, at least in Germany, can be the ex-post result of an unsustainable solvency position. Including them endogenously in the model does not reflect reality and seems to introduce circularity. – Lack of clarity on what EIOPA perceives as the difference between “ex post” and “ex ante” benefit reductions. – Definition and use of conditional benefits and contractual options. – It is unclear how expenses should be taken into account: legal expenses, administration expenses and actuarial/consultancy expenses are mostly borne by the sponsor. To simplify the calculation, we suggest ignoring them or – as an alternative – taking a fixed number. 	

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Q9.	<p>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?</p> <p>Yes, these adjustment mechanisms should be taken into account, under the condition that benefit steering is a regular steering instrument, which has been properly communicated to the members.</p> <p>The adjustment of pension benefits is strongly intertwined with Social and Labour Law in some Member States. In some Member States, the cutting of pension benefits is not possible and the employer is responsible for paying the benefit or guaranteeing a minimum return. This highlights the question if the supervision should apply to the IORP to the pension scheme (since IORPs can offer multiple pension schemes with different employers or different parts of a single pension promise can be managed by different pension institutions (eg DB plan with a DC part)).</p>	
Q10.	<p>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?</p> <p>The set-up and calculations as presented in this document are very complex and present a heavy administrative burden, especially for small IORPs. This can have a discouraging effect on offering pension benefits. The costs related will not be in line with the size. IORPs will have difficulties in ascribing specific values to subjective elements as the calculations for valuing security mechanisms, which is very complex due to the stochastic valuation. Given the complexity, it is</p>	

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	<p>recommendable to apply a simpler standard model. Along with this, the EFRP considers that the evaluation of the steering and adjustment is based on too many assumptions which make its outcome very sensible to any slight modification of any assumption.</p> <p>Furthermore, there is an almost complete absence of reference to, or detail on, multi-employer plans or those with employers who are from the non-profit making, charitable or quasi-public sector. This is a major omission, which would make it impossible correctly to assess the value of sponsor support for many large IORPs.</p> <p>In addition, the valuation of the sponsor support can be derived from the wealth of the sponsor which is available to give security to the pension promise. We would argue that wealth of the sponsor is just one measure of the value of sponsor support, and that also the longevity, standing and status of the sponsor are important – elements that are much harder to measure.</p> <p>There are other solutions that could be pursued, such as a stress test or taking the <i>full</i> maximum value of Sponsor Support completely as own funds into account.</p> <p>In general, we would like to give in consideration alternatives to the HBS like Asset Liability Management models, scenario analysis, continuity analysis and stress tests.</p>	
Q11.	<p>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)?</p> <p>As previously mentioned in the answers to questions 6 and 10, the valuation of the sponsor support and the pension protection schemes will be extremely difficult and subjective. Many sponsors do not have a rating, multi-employer and not-for-profit employers will face difficulties in the valuation of sponsor support. This issue and the different parameters are not sufficiently well developed and more guidance is required.</p>	

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	<p>The EFRP is concerned about the reliance on credit ratings in the computations. There was a clear commitment by representatives at the G20 summit to reduce the reliance on credit ratings in financial regulation. This point has been taken up by the OECD in redrafting the Core Principles for Occupational Pension Regulation and the European Commission in its draft revision of the Credit Ratings Regulation. In October 2010, the Financial Stability Board also argued that the reliance on credit rating agencies should be reduced. They proposed that standard setters and authorities should assess references to credit rating agency ratings in standards, laws and regulations and, wherever possible, remove them or replace them by suitable alternative standards of creditworthiness. The ECON Committee of the European Parliament also emphasized this point recently: “no EU law will be permitted to refer to credit rating for regulatory purposes”. It should be noted that the vast majority of employers who sponsor occupational pensions are not rated.</p>	
Q12.	<p>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.</p> <p>The EFRP does not agree with the methodology for valuing maximum sponsor support, because the assumptions made for cash flows, default probabilities and recovery rates are, at best, educated guesses. More investigation and guidance is necessary.</p> <p>The valuation of the sponsor support is extremely complex as explained in our answers to questions 6, 10 and 11. Furthermore, these valuations will be subjective and imply a “model risk”. These formulas refer to the current and the future profits of the sponsor. But how should the sponsor support of non-profit organisations or organisations which transfer their profit to the mother company be valued? And how many years of EBDTA should be included (the more years, the higher the value of sponsor support)?</p>	

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	<p>As a simplification for a first QIS, the sponsor support and/or the pension protection could be treated as a residual asset that fills a deficit shortfall between assets and liabilities including any capital requirement.</p>	
Q13.	<p>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?</p> <p>The EFRP wonders if financial markets will be deep enough to fulfill the requirements sets by EIOPA in HBS 3.13. Not all EFRP members agree that market-based valuation of liabilities is useful.</p> <p>If the European Commission and EIOPA impose market-based valuation of liabilities, the EFRP would welcome the principle of the use of the counter-cyclical premium. But we do not agree with the proposed approach and feels that more analysis and guidance from EIOPA is needed.</p> <p>A vertical shift in the yield curve does not change the volatility and hence does not adequately take into account the long-term nature of pension liabilities. It is not clear if the shift of 50 basis points is enough to reflect the long term nature of the pension liabilities of the IORP. Given current market circumstances, 50 bps seems to be a low number from an historical perspective. This needs further investigation.</p> <p>Besides that, this could possibly be illegal in many instances in Germany. Firstly, if assets/liabilities are separated without any possibility of transfer (eg. in respect of pensioners) and obligations do not give rise to future premiums, who makes up the shortfall if an asset defaults? Is it ethical that actives can enjoy benefit increases (due to investments in real assets) whereas pensioners can't (due to matched fixed income investment)? Because of these questions, we do not consider the matching premium methodology a realistic alternative for IORPs in Germany.</p>	

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	<p>The proposed criteria for using the matching premium seem to be ill-suited for IORPs, because it is directly copied from Solvency II. Using the matching premium will not be allowed for pension contracts based on intergenerational risk sharing, which is one of the distinctive characteristics of IORPs compared to insurance companies.</p>	
Q14.	<p>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?</p> <p>The use of the Level B discount rate is not very clear yet and further clarification is needed. In the consultation document there is no attention paid to how the level B discount rate will operate in connection with other adjustment mechanisms. A higher discount rate will automatically influence the value of the adjustment and/or steering instruments.</p> <p>Some Members of the EFRP argue that the level B discount rate is better suitable to the structure of their liabilities than the level A discount rate and would like to propose to use the Level B discount rate as starting basis discount rate.</p> <p>The calculation of the ‘Level B’ discount rate should be based on the real asset mix and expected rate of return of each asset class on the portfolio. Regarding the fixed income component: since it includes bonds and deposits, including only the yields of AAA and AA bonds eliminates other components that can have higher rates. Furthermore, we note that the 3% risk premium is fixed for all risk-bearing asset categories and not linked to the specific risk as determined by the asset allocation of the IORP. A rate in line with the IORPs asset allocation would be more appropriate. The level B discount rate should also reflect a long-term equilibrium return on the IORPs assets and not be based on today’s yield levels. It should use an average long-term risk-free interest rate. Of course, using an average risk-free interest rate that is higher than the current interest rates will create losses on the fixed income component of portfolios.</p>	

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	<p>In addition, there are some Member State specific issues. For example, German IORPs have significant investments in covered bonds (e.g. Pfandbriefe) which are not listed in HBS 8.18. The classification of such bonds would need to be clarified, among other things.</p>	
Q15.	<p>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?</p> <p>In more general terms, the EFRP regrets that provisions in the consultation document that do not come from the Solvency II directive have not been given sufficient consideration. A lot of new items need more in-depth research. Inflation risk is among the most important considerations for IORPs and the EFRP is surprised that they are not examined in greater depth by the QIS. More time will be necessary in order to set up an appropriate inflation risk module.</p> <p>The EFRP feels that wages and prices are national matters and that it would be inappropriate to prescribe a harmonised specification for these in order to calculate the expected inflation rate and wage growth. In some Member States, the IORP itself can adopt assumptions for these rates, or national or sectoral level mechanisms determine them.</p> <p>The EFRP also believes that the 1% salary increase above inflation is not appropriate for all IORPs. A reference to real salary increases would be more realistic and appropriate.</p> <p>An alternative could be to take break-even inflations implied by financial markets into consideration in an inflation risk module. These will lead to valuations consistent with financial markets, instead of the present proposal to use a valuation method inconsistent with financial market prices. Since there is no market for wage inflation, we would suggest using break-even inflation for price inflation plus x%, where the Member State and social partners should decide on</p>	

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	<p>the relevant factor x for the IORPs, thereby recognising that expectations on wages can be quite dispersed across Europe.</p> <p>Furthermore EIOPA should recognise that prices and wages are a national matter, possibly differing substantially between countries, and sometimes between companies or sectors. The EFRP would like to see a study to examine if this really can be applied across Europe without risking market distortions. The market for inflation-linked products is limited in Europe, which implies that there is the risk of market distortions.</p>	
Q16.	<p>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?</p> <p>General comment The SCR proposals appear to be directly copied from Solvency II.</p> <p>Some EFRP Members strongly disagree with the concept of the SCR itself.</p> <p>In the UK, the SCR is irrelevant for buy-outs of IORPs by insurance companies since the estimated SCR value will be higher than the estimated buy-out value. IORPs must know the market value of the buy-out through a market consistent valuation.</p> <p>Under Belgian Social and Labour Law, the sponsor always carries the final risk, so the IORP itself almost never bears any risk.</p> <p>Performing the SCR calculation According to our Members, it appears possible for IORPs to perform the necessary calculations. A significant part of the calculation will be done by the spread sheet to be supplied by EIOPA, so that understanding all of the formulae may not be a requirement, since the correct answer should emerge if the right data is put in. It is questionable whether IORPs will have the required input</p>	

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	<p>data let alone understand the output to the degree necessary to check plausibility and interpret the results.</p> <p>The technical specifications should contain more guidance, especially the way in which the loss-absorbing capacity of adjustment mechanisms and security mechanisms in the calculation of the SCR should be interpreted.</p> <p>Some elements are still unclear:</p> <ul style="list-style-type: none"> • How the sponsor default risk should be calculated for multi-employer funds, undertakings of a multinationals and non-for-profit employers; • Which assets would fall under the definition of “intangible assets”; it is unclear how to deal with expenses; • The definitions to determine in which SCR category a certain asset belong: for example, it is not clear how listed real estate should be treated. 	
Q17.	<p>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?</p> <p>Market risk & European economy</p> <p>Some EFRP Members disagree with the concept of the SCR itself. One reason for this is that this method provides an incentive for IORPs to invest in (risk-free) bonds instead of alternative investments or equity. These investments will require a higher solvency charge. IORPs are important suppliers of capital to listed European companies, small and medium-sized enterprises (SMEs) as well as a great number of innovative start-ups. A SCR regime for IORPs could overly limit their investment opportunities. This will not only result in expected lower returns and, therefore, expected lower pension benefits (or higher contributions), but this outcome would have also a negative impact on growth and employment in the European Union. The proposed IORP revision</p>	

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	<p>is not in line with Europe 2020 Strategy and with the aim of having more long-term investments in the European Economy.</p> <p>This undesirable incentive will be mitigated by the duration-based approach. The EFRP therefore supports the use of the duration-based approach, but recommends decreasing the prescribed stress level not only for equity investments but also for the other asset categories.</p> <p>Different risk categories</p> <p>We believe that – especially for the purpose of this QIS – some risks should not be included in the calculation of the SCR as they are not likely to be material for IORPs:</p> <ul style="list-style-type: none"> - Health risk - Intangible asset risk module - Pension disability-morbidity risk - Pension expenses risk - Pension revision risk - Pension catastrophe risk sub-module - Counterparty default risk module <p>Furthermore, some parameters of the different assumed risks are overestimated, whereas other risks are underestimated.</p> <p><u>Overestimated risks:</u></p> <ul style="list-style-type: none"> - Capital charges for market risk (although we realize that these parameters are directly taken from Solvency II) - Pension longevity risk: there is an element of double counting in the requirement to assume a 20% decrease in mortality rates as the best estimate used in calculation of the technical provisions already allows for future improvements in longevity - Pension disability-morbidity risk: the capital charge for pension disability-morbidity risk 	

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	<p>could be lower compared to insurers, since IORPs do not have the disadvantage of adverse selection (due to mandatory participation)</p> <ul style="list-style-type: none"> - Operational risk: IORPs are not-for-profit. IORPs do not have the risk of a profit-seeking strategy and that reduces the operational risk. - Benefit option risk: A “mass lapse event” would be extremely unlikely to occur in practice and would almost be equivalent to a wind-up situation. It should be remembered that upon termination, members’ accrued entitlements often remain in the scheme <p><u>Underestimated risks:</u></p> <ul style="list-style-type: none"> - Inflation risk is underestimated. Inflation risk could be considered in the calculation of the SCR, especially for unconditional inflation linked pension benefits and final salary plans. - Sovereign debt risk: It is remarkable that no capital requirement should apply to borrowings by or demonstrably guaranteed by national government of an EEA state. The recent crisis showed that government bonds are not risk-free. <p>Credit rating agencies The calculation of the different risks for the SCR relies very much on the credit rating of a sponsor and investments. However, the European Commission is reviewing the Credit Ratings Regulation, which will reduce the reliance on ratings in financial regulation. Relying heavily on credit ratings will introduce procyclicality into the solvency assessment of IORPs, thereby amplifying risk.</p> <p>SCR and double counting With respect to pension liability risks within the SCR, this risk would be double counted if IORPs should incorporate a risk margin into their technical provisions for adverse assumptions. In the Technical Specifications, no attention is paid to this possible double counting.</p> <p>We disagree with the proposal of including a risk margin into the technical provisions in order to create a safety net for wrong assumptions. This should be done in the SCR. Including uncertainty</p>	

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	<p>into the technical provisions themselves leads to the risk of piling up prudence on prudence.</p> <p>Confidence interval We would like EIOPA to share the common method to be developed in order to derive results on a 97,5% and 95% security level from results based on a 99,5% security level. In our opinion, this is not possible without recalculating all modules, as the effects of the different steering mechanisms may not be linear. Given that EIOPA intends to perform only one QIS before the EC presents a proposal for a Directive, we think that explicit calculation of at least the 97,5% and 95% security levels should be included in this QIS and IORPs themselves should have the possibility to calculate these. Without this information, we fear that any EC decision regarding the security level will be biased, because only one set of results will be available at the time. Inclusion of two additional confidence levels will put even greater stress on IORPs to finish the QIS within the given timeframe. This only adds to our remark that the timeframe is too tight for IORPs to properly complete the QIS.</p> <p>The EFRP stresses that, in its view, the EC should not choose any harmonized security level, but leave this up to individual IORPs/Member States.</p> <p>MCR The use of the MCR under a prudential framework is not clear yet. Therefore, we cannot answer the questions. We would like to ask EIOPA to be vigilant not to bring in any double counting of risks covered by the MCR and the SCR.</p>	
Q18.	<p>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?</p> <p>Under a full loss-absorbing capacity in case of a complete contract, the HBS funding ratio will always be 100% (like the funding ratio of an individual DC scheme). This is because changes in (market) conditions will impact the value of HBS items, but not the (holistic) funding ratio (and</p>	

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	<p>therefore this will lead to an SCR of 0). This implies that the SCR in the HBS context is possibly not a useful instrument in assessing the solvency position of IORPs, but only a very expensive exercise to test if the pension contract is complete.</p> <p>In the draft Technical Specifications, the way the loss-absorbing capacity of adjustment mechanisms and security mechanisms is not adequately taken into account in the calculation of the SCR. Specific details on how to calculate the net SCR parts are missing, especially the nBSCR(TP) and nBSCR(SM) and – the simplification of separating the effect of loss absorbing capacity of the technical provisions and of the steering mechanisms is inappropriate for most IORPs in which both depend on a funding ratio. The separation is no simplification as it requires double the calculations and an unclear treatment of interdependent effects.</p> <p>The EFRP proposes a direct calculation of a gross and a net SCR. It does not propose this for every risk category separately (with, perhaps, an exemption for sponsor default risk). The detour of any adjustment calculation is considered unnecessary and complex for the purpose of this QIS.</p>	
Q19.	<p>Q19. Do stakeholders believe that the calculation of SCR in the Operational risk module (Section 3.3) is adequate for IORPs?</p> <p>Operational risk exists for IORPs, but should not be taken into account in this QIS as a simplification. In some Member States losses due to operational reasons are covered by the sponsoring employer. It is the employer who chooses the funding vehicle for pensions, therefore, the employer is also responsible for its operational efficiency. Spreading a potential operational loss over the membership could therefore be in breach of labour law. Imposing a capital charge for operational risk is, therefore, inefficient and not needed. In addition, the cost of operational failure may be met by outsourced service providers.</p> <p>Nevertheless, if EIOPA would like to advice to the European Commission to incorporate a SCR for operational risk into the Technical Specifications, we think that the operational risk component of</p>	

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	<p>the SCR could be allowed to be inserted as a single parameter. Operational risk is certainly not the largest component of the SCR, and the reference to the size of past contributions is not expected to yield material differences between IORPs (relative to the size of the fund).</p> <p>The EFRP would like to highlight the special governance structure of IORPs. IORPs are not-for-profit. IORPs do not have the risk of a profit-seeking strategy and that reduces the operational risk.</p> <p>Where operational risk is already covered by other Directives (e.g. Mifid or UCITS), no further capital requirements should be asked.</p>	
Q20.	<p>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?</p> <p>The EFRP believes that some of the basic calculations are too complex, given the expected materiality of the risk and the purpose of this QIS. The proposed simplifications should be the basis formula.</p> <p>Many of these risks are either non-existent or immaterial for IORPs and should be left out of the QIS. The simplifications for Health risk, Intangible asset risk module, Pension disability-morbidity risk, Pension revision risk, Pension catastrophe risk sub-module and Counterparty default risk module are not (very) relevant for IORPs and should be excluded from this first QIS.</p> <p>The simplifications for mortality, longevity and catastrophe risk are adequate from a technical point of view, but the assumed stress scenarios are overestimated in our view (see also question 17). The proposed calculation method for interest rate risk could lead to double-counting of the spread risk and EFRP wonders whether an average calculation (the shock on interest rates based</p>	

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	on an average duration) could be used.	
Q21.	<p>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?</p> <p>The modules presented here were thought to be extremely complicated and the EFRP would welcome more simplifications. Given the purpose of this QIS, it is advisable to simplify substantially or remove this entire section.</p> <p>The treatment of sponsor default risk is not sufficiently clear. It is unclear how the sponsor default risk should be valued in multi-employer plans, industry wide pension plans and pension plans in the public sector. We propose not to take the sponsor default risk into account in the SCR calculation, especially for multi-employer plans and non-for-profit schemes.</p> <p>The proposed methodology at HBS.6.15 shows the probability of default of the sponsor assessed according to its “rating”. However, many employers that sponsor pension schemes do not have a formal rating – those in the not-for-profit or charitable sectors. Therefore, a different method would need to be found of measuring probability of default. Due to the short time for response, the EFRP has so far not developed a technical and concrete alternative.</p>	
Q22.	<p>Q22. Do stakeholders believe that the calculation of SCR in the Benefit option risk sub_module (Section 3.7) is adequate for IORPs?</p> <p>The EFRP believes that – especially for the purpose of this QIS – the benefit option risk should not be included in the calculation of the SCR, since it is not likely to be material in most of the Member States.</p> <p>The parameters laid down in this module are inappropriate for IORPs. In particular, a “mass lapse</p>	

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	<p>event” would be extremely unlikely to occur in practice and would almost be equivalent to a wind-up situation. It should be remembered that upon termination, members’ accrued entitlements often remain in the scheme. The present value of the termination benefit in most instances is equal to the actuarial reserve so that there is no strain on the fund. The same is true for transfers to another scheme.</p>	
Q23.	<p>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?</p> <p>The EFRP does not think that the criteria and the descriptions of financial and insurance risk mitigation are sufficiently clear and understandable for IORPs. More guidance on how the different risk mitigating instruments will influence the SCR (numerical examples) would be helpful for IORPs. Furthermore, especially the paragraph on rolling and dynamic hedging needs more attention. The definitions of when an IORP is allowed to use a rolling hedge program as full risk mitigation technique could benefit from further explanations. For example, it is not stated how IORPs could judge the risk that the hedge cannot be rolled over due to an absence of liquidity in the markets; how IORPs the costs of renewing the same hedge should calculate and how the additional counterparty risk that arises from rolling over the hedge should be determined.</p> <p>The instruments outlined in Section 3.9 and 3.10 may reduce risk as defined in the proposed “QIS accounting world”, but these instruments do not necessarily reduce the liabilities of IORPs (the benefits IORPs have to pay to their members). In particular, in some Member States schemes offering profit participation are legally required to calculate these profits according to historical cost accounting standards. Financial instruments designed to hedge intertemporal changes in asset prices do not alter the benefit that is promised to the employee.</p>	
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