

Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II		Deadline 31 July 2012 18:00 CET
Name of Company:	GESAMTMETALL - Federation of German employers' associations in the metal and electrical engineering industries, Berlin	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	Comment	
General Comment	<p>Despite the serious reservations expressed by all Member States concerned as well as national and European social partners, the planned quantitative impact study (QIS) also shows that the considerations of EIOPA and the Commission continue to be based on capital requirements for insurance companies (Solvency II). With regard to our fundamental criticism of the application of Solvency II to institutions for occupational retirement provision (IORP), we refer to the input for the EIOPA consultation on EIOPA's draft response to the Commission's call for advice (template on EIOPA-CP-11/006) of GESAMTMETALL dated 2 January 2012. The proposed specifications demonstrate very clearly that this criticism is justified. Even if we formulate a position on details</p>	

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	<p>of this draft, we maintain our fundamental criticism.</p> <p>The draft for the QIS technical specifications confirms that the considerations not only of the European Commission but also of EIOPA amount to a full harmonisation of the planned supervision regime for IORP. Yet a fundamental discussion on whether such full harmonisation designed for insurance companies is necessary or could potentially be harmful has not even been announced let alone concluded. A tailor-made European supervision regime for occupational retirement provision oriented primarily on minimum standards and the principle of subsidiarity is clearly more appropriate for coming to grips with the specific characteristics of occupational retirement provision.</p> <p>The scale and complexity of the proposed QIS specifications demonstrate how serious the effects of applying Solvency II capital requirements to IORP would be. Setting aside the possible quantitative impact, IORP and the companies they serve would be burdened with considerable bureaucracy. It is clear that IORP would have to hold more capital as a result of risk-based capital requirements. The holistic balance sheet approach (HBS approach) proves to be poorly suited to taking adequate account of the specific characteristics of occupational retirement provision and in particular to preventing additional burdens.</p> <hr/> <p>The proposed technical specifications are heavily inspired from the Solvency II framework for insurance companies, even though the Commission had said the rules for IORPs would not be just copied and pasted from Solvency II. We regret this back-tracking. The level of detail and complexity of the QIS is beyond the capabilities of most sponsoring companies and their IORPs. This might make sense in the insurance sector where the relevant expertise is available. This appears to show a desire to borrow from insurance industry regulations and apply them to occupational pensions. Accordingly the technical specifications are designed in such a way that sponsoring companies will have difficulties to answer or will not be able to comment properly.</p>	

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	<p>If that what is shimmering through this QIS concept becomes the blueprint for a new supervisory regime under the new IORP II Directive there is a significant risk to undermine the future motivation of sponsoring employers in the MS to set up and to use IORPs in future.</p> <p>The revision of the IORP Directive – and especially this consultation - is a very technical exercise. It is important to realise that the technicalities are very important, but they should be subordinate to the overall long term goals of the European Pension Policy. First comments of big European companies who sponsor their own pension funds as HR vehicles indicate that this exercise and its complexity is well beyond their capabilities. A new IORP Directive should not provide an incentive to scale back second pillar pension provision or to move the pensions outside the scope of the IORP Directive (moving back to first pillar pensions, shift to book reserves or individual defined contribution schemes). This is undesirable, given the fact that only 40% of the European employees is currently participating in a supplementary pension scheme and given the need of more supplementary pensions in Europe (see also EC White Paper on Pensions). Excessive supervision of the second pillar IORPs will increase the pressure on the first pillar, which is according to the Commission already under stress in many countries.</p> <p>The representativeness of the QIS is insufficient for an IORP II proposal by the EC (see question 1). Furthermore, in some of the eight participating Member States the QIS will not be performed by IORPs, but by supervisory authorities which are using aggregate data (or it is done by actuarial firms on behalf of the supervisory authority). However, it is our opinion that EIOPA and the Commission can only have a good indication of the real impact when the QIS will be performed by IORPs (instead of hypothetical schemes). The use of aggregated data makes the comparison between funds and countries meaningless and it will be very hard for EIOPA to have an adequate overview of the sensitivity to the assumptions.</p> <p>The time-schedule is too tight. Supervisors and the pension sector have very limited experience with the concept and the valuation of the holistic balance sheet. When stakeholders have more time to react on the technical standards, this certainly will improve the quality of the response</p>	

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	<p>and so the final technical standards. We do not see the added value of shortening the consultation period due to the imposition of an external timetable (I.10.1). The advantage of a better response and so better technical standard will definitely outweigh the benefit of a faster determination of the technical standards.</p>	
Q1.	<p>No, GESAMTMETALL does not agree with the general set-up of the QIS exercise. This because of the following three reasons:</p> <p><u>1) The QIS will not give all necessary insights for IORP II</u></p> <ul style="list-style-type: none"> • If this is the only QIS before the proposal of IORP II by the European Commission (as indicated by the European Commission), for sure not all relevant questions can be directed and clearly answered in one run. EIOPA should ask for even more information than it is already going to do in the complex QIS. • There is the risk that IORPs will not have enough time to be – and certainly are at the moment not – sufficiently equipped to reply (leading to a limited number of replies). Focus of responses will be on the technical details and not on general concept and usability of holistic balance sheet. • The resources needed to run a QIS style solvency process will be very expensive to the majority of IORPs (proportionality). Therefore, those that participate will be a biased sample of large pension plans – those that can easily absorb the cost. <p><u>2) The representativeness of the QIS is insufficient for an IORP II proposal by the EC:</u></p> <ul style="list-style-type: none"> • Only 8 out of 27 Member States will participate in the QIS. • Municipal/Local Authorities pension schemes are not included, although these are significant providers of second pillar pension schemes. 	

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	<ul style="list-style-type: none"> • In some Member States the QIS will not be performed by IORPs, but by supervisory authorities which are using aggregated data (or it is done by actuarial firms on behalf of the supervisory authority). However, it is our opinion that EIOPA and the Commission can only have a good indication of the real impact when the QIS will be performed by IORPs (instead of hypothetical schemes). • The use of aggregated data makes the comparison between funds and countries distorted and it will be very hard for EIOPA to have an adequate overview of the sensitivity to the assumptions. • If IORPs will not participate in the QIS, they will also not be able to respond (properly) to the qualitative questionnaire, while it is the purpose of the qualitative questionnaire to obtain an assessment by the IORPs of the clarity of the technical specifications, the quality of inputs and results, the methodology of the QIS, the practicability of the calculations involved and the use of simplifications. In addition, IORPs will be invited to give a first impression of the outcomes of the QIS and the potential policy reaction by the IORPs and other stakeholders. <p>3) <u>This exercise is very exhaustive:</u></p> <ul style="list-style-type: none"> • The exercise is dependent on many – debatable – assumptions like stable correlations, normal curves, absence of tail-risk and the ability for analysts to accurately predict the future. • The underlying principles of the Holistic Balance Sheet are based on full market valuation and a Value at Risk (VaR) methodology. However, based on the experiences over the last years, there are some second thoughts if this kind of models should be still applicable. • We have identified 972 scenarios that IORPs will be expected to compute. Many will not have inputs in the appropriate format. 	
Q2.	No, we do not think that the adjustment (discretionary and conditional benefits, last resort benefit reductions) and security mechanisms (sponsor support, pension protection schemes) are	

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	<p>taken into account adequately.</p> <p>If there will be only one QIS, this QIS should provide all the possible answers/ insights/ numbers in one QIS. With the current Draft Technical Standards and the set-up of the QIS this will not be possible. This is logical, since the adjustment and steering mechanisms are new elements (compared to other topics) for EIOPA to assess and it is unlikely that we can fully assess them correctly in one QIS. These mechanisms define the difference between pension funds and insurance companies, making the HBS even more complex than Solvency II. After 5 QISs the Solvency II framework is still unclear, with the discount curve (UFR, matching premium/counter cyclical premium) still undecided whereas the impact of the curve on the solvency position of insurance companies (and also on the markets and the economy) being extremely severe. The Commission and EIOPA will hardly be able to calibrate the adjustment and steering mechanisms right in one QIS for IORPs.</p> <p>It should be noted that EIOPA has detailed experience of insurance companies, but only limited experience of the holistic balance sheet and the valuation of the steering and adjustment mechanisms. Also consultants and the pension sector have very limited experience with the valuation of these mechanisms (and consultant capacity is currently focused on Solvency II).</p> <p>Pension protection schemes are an important security mechanism for occupational pensions in Germany. In contrast to other security schemes in the financial industry which are potentially exposed to systemic risk, the German “Pensions-Sicherungs-Verein” (PSV) is backed by 91,700 employers i.e. the majority of listed companies in Germany as well as a significant portion of medium-sized enterprises In the event of employer insolvency, the PSV assumes the liability of the benefits it has insured. Benefits are insured up to a cap of €7,878 per person per month. This level would generally exceed the level of benefit that IORPs could fund on a tax preferred basis on behalf of an individual.</p>	
Q3.	The “old-items” – which are obviously directly copied from Solvency II – are sufficiently clear and well documented. The “new-items” – such as the valuation of the steering and adjustment	

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	<p>mechanisms – are understudied and insufficiently clear and needs more guidance. Some examples:</p> <ul style="list-style-type: none"> - The Holistic Balance Sheet requires complex (option) techniques. There is little attention to these techniques in the Technical Specifications; - The relation between the valuation of the different steering and adjustment mechanisms and prudential framework is important, but unknown (e.g. length of recovery plans, tiering); - Many very difficult assumptions to value the liabilities and contingent assets: no market for long dated liabilities, for wage indexation and long dated volatility (important for contingent assets and liabilities like sponsor support and conditional indexation); - It is unclear how incomplete pension contracts/discretionary benefits should be valued; - How many years of use of steering instruments may be included? The more years of extra contributions, the lower the capital requirement. - The methodology to take sponsor (employer) support and pension protection schemes into account is of an incredible complexity and gives significant rise to doubts whether this issue and its nature (even from a social- and labor law perspective (SLL) is really understood due to the missing experience of EIOPA and MS supervisory authorities to deal with these SLL driven issues appropriately from a supervisory perspective. <p>Stakeholders should have the opportunity to respond not only to the technical standards, but also on a draft QIS spread sheet before the QIS will be performed. Furthermore, it would have been easier for stakeholders to respond to this consultation, if a draft spread sheet for the QIS was already attached to the consultation document.</p>	
Q4.	<p>As described above, the QIS will overwhelm many IORPs both in terms of human and financial resources necessary to carry out the exercise. For some, the QIS will not be feasible without employing external consultants, thereby creating a significant financial strain on the IORP.</p> <p>Given the similar complexity to Solvency II, we would expect the cost of the QIS and finally the implementation of an analogous IORP II regime would be very similar to the total Solvency II QIS/implementation cost for insurers. We, therefore, call on EIOPA to carry out a cost/benefit</p>	

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	analysis prior to carrying out the QIS. The technical specifications are based on an insurance business model which will be unfamiliar to many. In addition, the calculations proposed in the technical specification are overly complex and rely on too many assumptions creating model risk.	
Q5.	<p>We do not agree that the holistic balance sheet approach based on market-consistent valuation is appropriate for IORPs. In particular the valuation of sponsor support is too complex and especially ill-designed for multi-employer IORPs which are often among the largest IORPs.</p> <p>We are also concerned about the reliance on ratings in the computations. There was a clear commitment by representatives at the G20 summit to reduce the reliance on 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 Directive. It should be noted that the vast majority of employers who sponsor occupational pensions are not rated. These are especially to be found in the SME segment. By making the provision of pensions more expensive for this group of the workforce, EIOPA would be clearly acting against the aims of the European Commission as stated in its recent White Paper.</p>	
Q6.	<p>A risk margin is inappropriate in occupational pension systems with sponsor support and pension protection scheme (PPS). In these systems the IORP is simply a delivery mechanism for the benefit promise given by the employer and guaranteed by the PPS. In a going concern situation it is economically inefficient (both at the company level and at the whole economy level) to fund the IORP over and above the long-term value of liabilities. Moreover the cost of capital concept is not relevant for IORPs as they do not raise capital in the financial markets, nor are pension liabilities traded in an active market.</p> <p>Furthermore, some valuation assumptions have built in risk buffers (e.g. mortality assumptions). Adding an explicit risk margin would be double counting (adding an SCR would then be triple counting.)</p> <p>Further simplifications in the valuation of sponsor support and PPS are necessary. Even the proposed simplification for the valuation requires data that many companies usually do not</p>	

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	<p>determine, e. g. the EBTDA for the next coming years.</p> <p>Focusing the valuation of sponsor support on few large employers may be feasible for schemes where these sponsors are liable for a significant portion of the benefits but not for a scheme that for example has over 40,000 sponsoring employers and whose top 5 sponsors make up approx. 5% of the contributions to the scheme. In the latter case, the probability of default could simply be set to 0, as the probability of all sponsors defaulting at the same time is effectively that.</p> <p>It is not justifiable to use commercial ratings to estimate the default risk of sponsors, nor is it reasonable to assign unrated employers the highest probability of default for the following reasons:</p> <ul style="list-style-type: none"> - Some IORPs service many (unrated) small employers in a particular industry. The lack of reliance on a single employer arguably reduces exposure to default risk. - Many IORPs are sponsored by public entities which are not rated and whose probability of default is very small. - Some IORPs are sponsored by un-rated subsidiaries of foreign (rated) multinationals. The rating of the parent, however, is irrelevant as the parent is not liable for pensions in a local jurisdiction. - The vast majority of employers who sponsor occupational pensions are not rated. These are especially to be found in the SME segment. Therefore assigning unrated employers the highest probability of default would discriminate against SMEs by making their occupational retirement provision more costly. 	
Q7.	<p>We believe that IORPs will be able to take into account this trend in mortality rates. The providers of mortality tables need to be reputable. Currently, not all Member States take into account ‘future trends’ in their calculations / mortality tables. Also, mortality is heavily related to the national circumstances. So such issues should be left up to national working groups: to assess and propose how they can best be incorporated in the future in their specific Member State.</p>	

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Q8.	<p>No, it is not clear enough from the technical specifications what cash flows should be taken into account in the calculation of the best estimate. There is a clear case for more guidance, to assure some utility and comparability of the outputs. For example, more guidance is required for:</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 very hard to make a distinction between those; • Difference between “ex post” and “ex ante” benefit reductions; • Definition and use of conditional benefits and contractual options. <p>Pension plans in Germany typically provide defined death and disability benefits. The valuation of these is integrated with the valuation of retirement benefits, therefore, it may not be feasible to value these as a separate plan.</p>	
Q9.	<p>The possibility to reduce benefits in the valuation of the best estimate of technical provisions 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>	
Q10.	<p>First of all, this question highlights the differences in the relationship between sponsors between the different Member States. This implies that these technical specifications could be possible in one Member State, but not in the other.</p> <p>We have some serious concerns with the principles for the valuation of sponsor (employer) support:</p> <ul style="list-style-type: none"> – The proposed method for the valuation of sponsor support is too complicated and thus too expensive. – Employing sophisticated modelling techniques that forecast the sponsor’s financial capacity depend on mean (Central Limit Theorem) forward assumptions behaviour; – In reality the outcome will mostly be bifurcated, i.e. the sponsor can either cover or not cover the deficit. 	

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	<p>We believe that it will not be possible to find one single method that can assess sponsor support in a both reliable and simple way for all IORPs in the EU. Therefore, if the HBS-approach will be realized, it should be left to the MS to implement an adequate method. EIOPA should confine itself to supervising that those methods are implemented.</p> <p>Possible methods of assessing the sponsor support could e. g. be based on the present value of the deficit and the capability of the sponsor to cover the deficit today – through the issuance of a bond. If the sponsor is a public and listed company with credit default swaps: The pension fund liability and the ability to fund the liability will manifest itself in the pricing of the sponsor/issuer’s CDS. Especially for SMEs, it might be sufficient to consider the equity ratio.</p> <p>Furthermore, it is unclear how multiple sponsors for industry-wide pension schemes and the value of the sponsor in public sector pension schemes have to be valued. It would not be appropriate just to add the capital required for the different sponsor companies without regarding the risk balance ensured by the community of sponsors.</p> <p>Pension Protection Schemes (PPS) should be definitely incorporated into the holistic balance sheet as an asset (HBS 6.60). We also strongly endorse the notion of HBS 6.71: if the PPS covers 100% of the benefits and is sufficiently strong, its value should close the funding gap - without any further calculations being necessary.</p> <p>Alternatives for the proposed valuation and the holistic balance sheet are ALM studies (Asset Liability Management), scenario analysis and/or stress testing. This is simpler than the holistic balance sheet, because probability weighted mark-to-market valuation requires ALM scenarios including discount factors (like risk neutral valuation or deflators). These kinds of alternatives should be studied before a new IORP Directive will be proposed. Also, additional fundamental studies are needed how sponsor (employer) support and PPS, being SSL issues at their core and offering high level protection, affect supervisory structures.</p>	

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Q11.	In general, a simplification would be better than the complicated mathematic calculations (for the first QIS). We want to highlight that it would be difficult to provide any meaningful parameters on the probability of default and recovery rates, using financial models with extensive time horizons. Little comfort can be achieved through an average expectation, because the situation will vary considerably from sponsor to sponsor.	
Q12.	No, see previous answers.	
Q13.	<p>We endorse any counter cyclical measures in specifying solvency standards. These would be achieved by using valuation assumptions that are based on long-term equilibrium values and not short-term market rates. Shifting the yield curve by 50 bps is arbitrary, will have little impact and does not adequately take into account the long-term nature of pension liabilities.</p> <p>The matching premium methodology raises a number of issues with regard to intergenerational equity and could possibly be illegal in many instances in Germany. Firstly, if assets/liabilities are separated without any possibility of transfer (e.g. in respect of pensioners) and obligations do not give rise to future premiums, who makes up the shortfall if an asset defaults? Is it justifiable 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>	
Q14.	We strongly welcome the proposal that there will also be a "Level B" discount rate in the QIS, based on expected returns of the strategic asset allocation rather than a risk-free discount rate, but do not agree with the proposed way to derive the level B discount rate. The level B expected return locks in bond rates at current levels. We propose a long-term historical average of the returns instead, based on bonds with a maturity of at least 15 years, to adequately reflect the duration of pension liabilities. Furthermore, the fixed risk premium of 3% for all other kind of assets does not correspond with the different level of riskiness of these assets (as prescribed in the SCR standard formula). So, there will be an imbalance in risk-return trade-off and a strong incentive to invest in property (same expected return, but lower capital requirements than	

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	equity).	
Q15.	We do not agree with the draft technical specifications for a fixed yearly percentage of respectively 2% and 3% for the expected inflation rate and salary growth. It is quite remarkable that the core principle of market valuation is not used for one of the most important risks for a pension fund.	
Q16.	<p>The description of the SCR will not be sufficiently clear and understandable for smaller IORPs, who will not participate in the QIS.</p> <p>It seems as if a significant part of the calculation will be done by a spreadsheet to be supplied by EIOPA. It is questionable whether IORPs will have the required input data let alone understand the output to the degree necessary to check plausibility and interpret the results. It is not clear how EIOPA will infer other security levels from the calculations on a 99.5% level given that the results will be non-linear. It is not clear which assets would fall under the definition of “intangible assets”.</p>	
Q17.	<p>Before the question if stakeholders believe that the risks IORPs are facing are adequately reflected in the calculation of the SCR and MCR will be answered, we would like to mention that it is not clear how EIOPA will infer other security levels from the calculations on a 99.5% level. Due to the (option) valuations of the adjustment and steering mechanisms, other security levels can not be derived from the 99.5% level (since there is no longer a normal distribution). In addition, the calculation of the different risks for the SCR rely very much on the credit rating of a sponsor and investments. This is remarkable since MEP’s are aiming to reduce over reliance on ratings. According to a recent ECON vote, <i>no EU law will be permitted to refer to credit rating for regulatory purposes</i>. The objective for a MCR within a prudential framework for IORPs is unclear. Therefore, it is not possible to respond to the question if the risks IORPs are facing adequately reflected in the calculation of the MCR.</p> <p>SCR Risks</p>	

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	<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:</p> <ul style="list-style-type: none"> • Health risk (in most Member States) • Operational risk • Intangible asset risk module • Market risk concentrations • Pension disability-morbidity risk • Pension revision risk • Pension catastrophe risk sub-module • Counterparty default risk module - except for sponsor support <p><u>Market risk:</u></p> <ul style="list-style-type: none"> – We would like to ask attention to the fact that the capital requirements for equity as proposed will provide a strong incentive for pension funds to change their asset mix into more bonds and will therefore drop out as investors at the stock market. <p><u>Pension longevity risk:</u></p> <ul style="list-style-type: none"> – There is an element of double or even triple counting in the requirement to assume a 20% decrease in mortality rates as the best estimate used in calculation of the technical provisions already includes future improvements in longevity and IORPs possibly have to use a risk margin in the valuation of their technical provisions to provide for insecurity around the longevity trend included. <p><u>Pension disability-morbidity risk:</u></p> <ul style="list-style-type: none"> – The capital charge for pension disability-morbidity risk could be lower compared to insurers, since IORPs do not have the disadvantage of adverse selection (due to mandatory participation) 	

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Q18.		
Q19.	<p>We think that operational risk can be ignored in a first QIS or otherwise could be a fixed number (as a simplification).</p> <p>Next to that, we would expect that the operational risk of IORPs should be at a lower level than for insurance companies (and therefore lower than the proposed parameter in the consultation document), since IORPs are not-for-profit organisations and therefore do not have the operational risks of a profit-seeking strategy. In addition, the cost of operational failure may be met by third parties e.g. the sponsor or outsourced service provider meaning that the IORP would not suffer any financial impact from the operational failure.</p>	
Q20.	<p>First of all, we believe that some of the basic calculations are too complex, given the expected materiality of the risk and the purpose of this QIS. Start simple and possible sophistication in later stages will result in a better outcome. As discussed earlier, certain risk categories are not relevant for IORPs (such as catastrophe risk) and should at the least be excluded from this first QIS.</p>	
Q21.		
Q22.		
Q23.	<p>The instruments outlined in this section may reduce risk as defined in this QIS, however, they do not necessarily reduce the liability of IORPs which are the benefits that must be paid to members. In particular, schemes which offer 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 and, therefore, do not contribute to risk mitigation in a real sense.</p>	
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	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
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	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
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	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
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	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
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	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
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	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
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