Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II		Deadline 31 July 2012 18:00 CET
Name of Company:	**Tesco Plc**	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	**Public**
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-12-003@eiopa.europa.eu. Our IT tool does not allow processing of any other formats.** The numbering of the paragraphs refers to Consultation Paper 12-003.	
Reference	**Comment**	
General Comment	**Background to Tesco and our pension arrangements** Tesco is one of the world's largest retailers, with operations in six EU member states – the UK, Republic of Ireland, Poland, Czech Republic, Slovakia and Hungary. We are a major contributor to the EU economy, with around 4,000 stores and over 375,000 employees across our markets. Our award-winning UK pension scheme (the Tesco PLC Pension Scheme) is one of the largest private sector defined benefit schemes that still remains open to new employees. We have around 170,000 employed members and over 290,000 participating members in total. We have no minimum hours or earnings restriction. This means thatevery Tesco	

employee can earn benefits in our scheme – no matter how low their earnings are.

Almost 60% of our members are female. Over 90% of automatically enrolled staff choose to stay in the scheme and say it is a great way to save for the future.

Our Tesco Ireland Pension Scheme also remains open to new employees - with around 3,000 employed members in total. Tesco Ireland is one of the few companies in Ireland to continue to offer a defined benefit pension to both new and existing employees.

Given the financial significance of our UK defined benefit scheme we have chosen to focus our comments on the potential impact of a Solvency II-style regime on the UK. However, this does not in any way indicate that we believe this is a UK-specific issue. On the contrary, these proposals have significant implications for the wider EU economy and the adequacy of pension provision across all 27 member states.

General Comments

Tesco fundamentally opposes the application of a Solvency II-style funding regime to defined benefit schemes on principle, as set out in our response to EIOPA's Call for Advice in December 2011. While we support the Commission's objective to achieve adequate, sustainable and safe European pensions systems, we believe a Solvency II-style regime would do nothing to help achieve this goal.

We urge the Commission to allow considerably more time for several thorough impact assessments, in order to fully address widely-held concerns around the negative impact of the proposals on pension provision, employers and the EU 2020 growth agenda.

A Solvency II-style regime would weaken – not strengthen – EU pension provision

While the Commission's aim is to improve pension security, Solvency II-style rules would actually reduce adequacy of pension provision for future generations and discourage retirement saving. This is because Solvency II rules would require companies to invest more in respect of benefits that members have already built up - resulting in less money to spend on future pension provision.

DB schemes would become too costly to run and as a result force companies to close such schemes to all members. Future pension provision would have to be provided by defined contribution (DC) schemes, where members undertake the risk instead of the employer, and companies would be forced to contribute less to these schemes given the higher costs imposed by Solvency II.

In a worst case scenario, Solvency II-style proposals could force companies into insolvency. This would lead to job losses and put a strain on the State, as more people are likely to rely on the State in the absence of adequate occupational pensions. Not only does this undermine the Commission's original objective, but also the Flexicurity agenda, which aims to create *more* security for employees.

Solvency II rules would be disastrous for the EU economy

Higher funding requirements would force businesses to divert money away from investment in growth, enterprise and job creation, undermining the EU's economic goals at a critical time. In practical terms, this may restrict Tesco's capital for store development, Regeneration Partnership schemes and jobs for the long-term unemployed. This may also lead to a loss of tax revenue for the State in the form of corporation and income taxes, and VAT.

The proposals could also destabilise already volatile financial markets and drive capital out of the EU. Pension funds would be forced to shift to low-return investment strategies, choosing bonds over equities, which could significantly impact companies' share prices and their ability to raise capital in the markets.

The current IORP Directive works well and respects subsidiarity

Given the diversity of member states' pension arrangements, which are tied to national

	social and labour laws, it is not appropriate to impose a rigid funding regime for all. The UK system works very well and already provides a strong governance and funding framework, which has proven robust during the economic crisis. A number of different security mechanisms are already in place, including the Pension Protection Fund, the Pensions Regulator and "debt on employer" regulations, which prevent an employer from abandoning a scheme if it is not fully funded. In many cases, assets set aside for pension benefits are also underpinned by contingent assets from the company to provide further security in the case of employer insolvency. **A solvency regime for the insurance sector is inappropriate for pension funds** We agree with the European Economic and Social Committee's opinion[1] that insurance companies and occupational schemes are not comparable, and therefore reject the idea that there should be a level playing field. Firstly, unlike insurance companies, workplace pension funds do not operate on a commercial basis - they are part of an employer's benefit package for staff. Secondly, Solvency II was specifically designed to address the short term volatility risks in the insurance sector. It would be wrong to apply the regime to pension funds, which are long-term in nature. Unlike in the insurance sector where once the premium has been collected there is no other funding to make up the shortfall, in pension funds employers and trustees regularly monitor the funding position of the fund and companies regularly pay in additional money when needed.	
Q1.	**The consultation period is far too short for such complex and lengthy proposals** Six weeks is far too short a consultation period for such important policy proposals which have significant implications for employers, pension holders and the EU's 2020 growth	

[1] European Economic and Social Affairs Committee (July 2012), Opinion on the White paper - An agenda for adequate, safe and sustainable pensions, COM(2012)

agenda. Given the length and complexity of the consultation document, there is simply insufficient time for stakeholders to be able to fully understand and analyse the complex calculations put forward in the Holistic Balance Sheet (HBS). This is particularly the case where entirely new concepts have been proposed, such as how to value the sponsor covenant and pension protection schemes. These aspects could be addressed in a QIS in their own right given their significance to IORP scheme security.

Furthermore, we wish to record that the consultation fails to meet the Commission's own general principles and minimum standards for EU consultations, which stipulates a minimum of 8 weeks[2].

The wider IORP Directive review process is being rushed and is not conducive to sound policy making

We are concerned that the wider IORP Directive review process is being rushed and will not lead to carefully considered legislative proposals. The Holistic Balance Sheet and proposals concerning Pillar 2 and Pillar 3 of the Solvency II Directive raise many challenging issues which require more detailed examination through several rounds of QIS. Indeed, EIOPA has carried out no fewer than five QIS exercises in its assessment of the impact of the Solvency II Directive on the insurance sector. Given we are dealing with the same substantive matters – capital adequacy and risk management requirements – with the additional complexity of valuing sponsor support and the PPF, there is no reason why pension funds should not be given the same careful consideration.

It may also be prudent for the Commission to complete its impact assessment of the Solvency II Directive on the insurance sector before proceeding further with the IORP Directive review. The Solvency II Directive is still a work in progress and many would agree it has not been a smooth process. Given the importance of pension funds to future economic growth and investment, it would be sensible to wait until Solvency II has been

[2] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2002:0704:FIN:EN:PDF

properly implemented by member states.

In this regard, we are pleased that Commissioner Barnier intends to publish a Green Paper on the impact of financial regulation on the insurance sector's ability to make long-term investments. It is vital that any future EU regulation does not impede pension funds from providing and channelling long-term investment.

The consultation fails to indicate the real impact of the Holistic Balance Sheet on pension scheme funding

It is impossible for stakeholders to make sensible judgements on the QIS methodology and give robust responses without knowing how the HBS would work in practice. The consultation simply sets out the methodology and formulae for the valuation of assets and liabilities, without stating the implications of using these calculations: what funding actions would Trustees or employers have to take if the HBS did not balance, and within what timescales? There is also no indication of how the HBS would affect current funding requirements in the UK and in specific IORPs.

EIOPA should take a principles-based approach to funding requirements, leaving implementation to individual member states

The task of devising a robust funding methodology that caters for different markets, types of pension provision and legal frameworks across 27 national pension systems is a Herculean one. EIOPA would be better placed to set out a broad framework and allow individual member states to implement these principles. This would ensure that the funding requirements are flexible enough to allow for both pension system differences between member states and differences between individual IORPs. It would also keep costs and time dedicated to these calculations to a minimum, as they could be integrated into existing funding requirements.

Q2.	**The proposed approach to valuing pension protection schemes and sponsor covenant is too complex** EIOPA's proposed approach to valuing pension protection schemes and sponsor covenant is far too complex, creating unnecessary extra work and increased costs with no added value. Again, it is a very difficult task to devise a formula to value 27 different pension systems with varying security mechanisms. We believe EIOPA would be better placed to devise a broad framework, leaving the detailed methodology and implementation to member states, with the flexibility to cater for the different circumstances of individual IORPs and security mechanisms. Furthermore, it is impossible to give meaningful comments on EIOPA's proposals when it has specified that the techniques outlined for pension protection schemes and sponsor covenant may not be the ones that will be implemented in practice. In this regard, it would also be helpful for EIOPA to share the spreadsheets on valuing the pension protection scheme with stakeholders, as this would improve the quality of consultation responses in this area. In general, we ask that a simpler method is adopted and the consultation is extended to give more time for the industry to explore alternatives. **Pension Protection Schemes and additional security mechanisms should be recognised in the Holistic Balance Sheet** We are very concerned that EIOPA is considering omitting pension protection schemes from the HBS. The UK's Pension Protection Fund (PPF) is a fundamental part of the UK pension system. In the UK, companies with a defined benefit scheme pay a levy to the PPF. The levy ensures that, in the event of employer insolvency, the PPF can provide a significant proportion of the member's original benefits. Including the PPF in the HBS would also provide an objective representation of the	

	“solvency” position of an IORP. This would usefully allow direct comparison of the financial position of IORPs in different member states. **The HBS fails to recognise the value of good governance – one of the strongest mechanisms to ensure pension security in the UK** The Holistic Balance sheet fails to take into account the benefit that strong governance structures have in improving the security of members‘ benefits. In the UK we have formal Trustee boards who have a legal duty to regularly monitor and challenge companies as part of the funding regime. We also have the Pensions Regulator who has the power to force companies to pay more into the pension scheme. These elements should also be recognised and included as “assets“ on the HBS.	
Q3.	**Many of the assumptions to value assets and liabilities in the Holistic Balance Sheet are arbitrary** We have concerns that some of the assumptions used to value assets and liabilities (for example, the 2% inflation rate; 8% risk free margin and 50% shareholder funds to value the sponsor covenant) are arbitrary, with no clear rationale behind the figures. More generally, we question whether it is possible and even wise to prescribe such figures given we are operating in an uncertain economic climate. EIOPA should take a less prescriptive approach so that pension funds have the flexibility to adjust their asset mix and manage liabilities to account for market fluctuations. By setting these assumptions, EIOPA will be injecting further volatility and short termism into the pension funding framework. We would urge EIOPA to adopt a flexible approach given the long term nature of pensions. **The draft technical specifications are not sufficiently clear for pension funds**	

	While elements of the draft technical specifications lifted directly from the Solvency II Directive will be very familiar to the insurance community, they will not be understandable to the vast majority of UK pension schemes who have not been part of the development of the Solvency II.	
Q4.	**The consultation and future QIS pose huge, unnecessary cost to pension funds** Given the lengthy and complex nature of this consultation, analysing the proposed calculations will involve huge additional cost and resource for pension funds. Employer sponsors will have to spend substantial sums on consultancy and actuarial fees – money which would otherwise be put into the pension fund. Similarly, participating in the future QIS will also be a very costly exercise. We do not see the value of introducing an entirely new methodology when the current UK system works very well and provides a strong security and funding framework. A number of different security mechanisms are already in place, including the Pension Protection Fund, the Pensions Regulator and “debt on employer” regulations, which prevent an employer from abandoning a scheme if it is not fully funded.	
Q5.	No. As discussed above, the consultation provides no indication of how the HBS will be used in practice and as a result the guidance on how to set up and value the HBS is effectively meaningless. Furthermore, we are unable to comment on the guidance as we would need to outsource valuation of the Holistic Balance Sheet to consultants or actuaries at significant cost. The calculations are far too complex and resource-intensive to carry out internally, and would add an additional layer of complexity to the existing UK funding framework.	
Q6.	No. Simplification of the valuation of the Holistic Balance Sheet has no meaning without knowing how the HBS will be used in practice. Also, as stated previously, no rationale has	

	been provided for certain assumptions and simplifications, i.e. a risk margin of 8%, so we are unable to give meaningful comments. Additional time is needed to explore and understand the proposals and discuss alternatives.	
Q7.	The reference to “recent tables” is not clearly defined. We do not expect the principle to be an issue for UK IORPs. However, it is not feasible to envisage a single mortality trend but rather different trends, which will vary by sector of the workforce and by member state.	
Q8.	We require more time to explore this element further. It is important, however, that salary increases to ‘past service’ benefits are considered ‘discretionary’, where an employer has the option to cease the salary link in the future.	
Q9.		
Q10.	As stated in Question 2, the proposed approach to valuing pension protection schemes and the sponsor covenant is too complex. Again, it is a very difficult task to devise a formula to value 27 different pension systems with varying security mechanisms. We believe EIOPA would be better placed to devise a broad framework, leaving the detailed methodology and implementation to member states, with the flexibility to cater for the different circumstances of individual IORPs and security mechanisms. Furthermore, it is impossible to give meaningful comments on EIOPA’s proposals when it has specified that the techniques outlined for pension protection schemes and sponsor covenant may not be the ones that will be implemented in practice. In this regard, it would also be helpful for EIOPA to share the spreadsheets on valuing the pension protection scheme with stakeholders, as this would improve the quality of consultation responses in this area.	

Q11.	The parameters should be scheme and sponsor-specific. We have concerns with using ‘credit rating’ to determine the risk of default as there are many factors that need to be taken into account in addition to credit rating. Furthermore, not all companies will have a credit rating, and so a more inclusive factor should be considered. It is also unclear in the guidance who the ‘sponsor’ is, i.e. where there are multiple employers or complicated Group structures.	
Q12.	The methodology is far too complex to understand. Pension schemes who can afford to undertake the calculations may well simplify the methodology, which will lead to spurious results.We believe further time should be provided to allow consideration of alternative approaches.	
Q13.		
Q14.	We welcome the principle of including the Level B discount rate, and believe more time should be given to explore and understand how this will be used in the HBS.	
Q15.	No. As stated in Question 3, the 2% inflation rate is arbitrary, with no clear rationale behind the figure. Inflation should be market-related. The 3% expected salary growth is also arbitrary and should instead be set on a case-by-case basis, depending on what pension fund Trustees and the company deem appropriate. More generally, we question whether it is possible and even wise to prescribe such figures given we are operating in an uncertain economic climate. EIOPA should take a less prescriptive approach.	
Q16.	No. We believe the calculation is too complex and would urge that a simpler approach is considered.	
Q17.	As discussed above, the consultation provides no guidance on how these calculations will be used in practice, so we cannot comment on this element.	

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Q20.		
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