

Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II		Deadline 31 July 2012 18:00 CET
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Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	Comment	
General Comment	We appreciate the Commission's intentions to set up a framework for enhancing adequate, safe and sustainable pensions in Europe , and feel that the Holistic Balance Sheet Approach could be a step towards that purpose. However, we think the concept should not be overly complex. We are surprised and disappointed by the level of complexity and rigidity of the QIS technical specifications. A revised IORP Directive should not discourage employers from offering pension	

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	<p>provisions that are more secure for members (which is not to say that a revised IORP Directive should allow employers to offer pension provisions that are only seemingly secure for members). It seems that the technical specifications focus primarily on the safety of pension provisions, without paying due attention to adequacy and sustainability.</p> <p>A revised IORP Directive must not be overly stringent on countries with efficient pension systems, but rather it should stimulate countries with no or less mature systems to improve their pension provisions. For mature systems, significant changes in regulation are likely to cause significant redistributions between shareholders. The Commission should be aware of this, and should consider transitional regimes where applicable.</p> <p>Our company’s letter to the Commission of June 11, 2012 gives an idea for a more pragmatic route to a more pragmatic Holistic Balance Sheet Approach. Our recommended approach would allow EIOPA first to gain significant experience with the diversity of pension arrangements in the European Union before imposing a regime that appears to us to be inappropriate for the objectives set.</p> <p>It is our impression that the timescale for the consultation, as well as for the QIS itself and the processing of the findings of the QIS resulting in the revised IORP Directive, is unrealistic. We regret that the consultation period (for a single QIS that is in fact more condensed than any of the five for insurers) has been contracted by 50%. The contents of the consultation seem to indicate that the timescale for writing the draft specification has also been restricted. Elements taken from Solvency 2 are very (and at times perhaps unnecessarily) detailed, whereas elements that are brought in specifically for the IORP Directive are relatively generic.</p> <p>The confidence level is one (important) element that has been taken directly from Solvency 2. A level lower than 99,5% may well be more appropriate for IORPs, and we welcome the fact that the impact of other confidence levels will also be reported. In responding to the consultation, we would have appreciated some more detail on the method to be developed by EIOPA to reflect the lower confidence levels. We expect this detail will be provided in the QIS.</p>	

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	<p>The current consultation gives no insight into regulatory consequences of the IORP Directive. For example, it does not indicate what happens if a balance sheet proves to be imbalanced. Nor does it say anything on financing and contribution requirements.</p> <p>Although regulatory consequences may be out of scope for the current consultation and the QIS itself, we feel that it is difficult if at all possible for shareholders to judge what the impact of the IORP Directive will be without these specifications, such as recovery periods. On a more technical level – future financing as well as (other) regulatory consequences may influence ‘non-unconditional’ elements in a plan, such as in the Dutch situation the future indexation of accrued benefits, as well as the possible reduction of the same benefits.</p>	
Q1.	<p><i>Do stakeholders agree with the general set-up of the QIS exercise as put forward in the Introduction (Chapter 1)? What improvements do stakeholders suggest?</i></p> <p>We have raised a number of general concerns with the approach in our general comments. Based on our experience with insurers related to Solvency 2, we expect that only the very largest schemes will be able to provide the information requested in the QIS to the full detail.</p>	
Q2.	<p><i>Do stakeholders believe that the adjustment (discretionary and conditional benefits, last resort benefit reductions) and security mechanisms (sponsor support, pension protection schemes) IORPs dispose of are taken into account adequately?</i></p> <p>We think this is one way to represent the the adjustment and security mechanisms. Having said that, it does seem to us that for the Dutch context the valuation is overly complex. Aside from sponsor support, the HBS must, by definition, balance. The values of future indexation, benefit reduction and accrued benefits should add up to the value of the assets. A full stochastic valuation would then determine the values of each of the three components. If it is the purpose of the IORP Directive to provide more transparency to members, we doubt that this approach will provide that transparency. The ratio between the values will be different between members. A continuity analysis (an ALM-like approach that is currently an element of the Dutch Financial Assessment Framework) may well provide more insight for individual members, as it yields the expected indexations and reductions as well as other percentiles for each year into the future,</p>	

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	<p>rather than the total value of each component.</p> <p>There appear to be complexities arising from uncertainty as to exactly what benefits constitutes an unconditional, conditional, discretionary or mixed benefit. This inevitably leads to considerable scope for different Member States (or, within an individual country, different IORPs) to make their own judgements.</p> <p>With respect to sponsor support: we doubt whether it is always clear what part of the contribution relates to existing obligations and should or can therefore be considered additional contributions. We note that the fact that regular contributions aren't referred to in the consultation adds to this lack of clarity.</p> <p>Arbitrarily determined variables are applied in a number of critical points, such as (amongst others):</p> <ul style="list-style-type: none"> • the 50% recovery rate (HBS 6.17); • the assessment of future profits and sponsors' earnings (HBS 6.36); • the proportion of shareholder funds available for the IORP; • the 50 bp adjustment to allow for the illiquidity premium (HBS 8.12); • the inflation and salary increase assumptions (HBS 8.23 and 8.24, respectively); • the mortality and longevity shocks of 15% and 20 % (SCR 7.17 and 7.29, respectively) and • the figures in the counter-party default risk module. 	
<p>Q3.</p>	<p><i>Do stakeholders believe that the draft technical specifications provide enough information and are sufficiently clear and understandable? Which parts could be improved upon?</i></p> <p>The amount of information is, as mentioned before, too large for some elements, and too limited for other elements. The technical specification is in our view far too complex considering that for many parties involved this is the first time they will have considered pension provision from a perspective that is entirely different from their current regime.</p> <p>Providing examples will enhance the clarity, as well as the purpose of the specifications.</p>	

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Q4.	<p><i>Do stakeholders believe that the calculations proposed in the technical specifications are feasible at appropriate costs and with appropriate accuracy within the given timeframe of the QIS?</i></p> <p>We expect that the full scope of the QIS will only be feasible for a very limited number of very large IORPs, with limited time to consider the impacts. Significant simplifications and approximations may be necessary. This, as well as the fact that smaller IORPs may not participate at all, may lead to biased results.</p> <p>We question whether the benefits of the Solvency II-induced regime justify the costs and upheaval that the proposals will undoubtedly entail.</p>	
Q5.	<p><i>Do stakeholders believe that the draft technical specifications provide enough guidance on how to set up and value the holistic balance sheet as discussed in Chapter 2? If not, which parts could be improved upon and in what way?</i></p> <p>Our experience with helping insurers understand and implement the requirements of Solvency II suggests that setting up valuation systems to carry out stochastic calculations for discretionary benefits would be a non-trivial and therefore costly exercise.</p> <p>We also repeat comments made earlier that</p> <ul style="list-style-type: none"> • we doubt that the guidance is sufficiently detailed to result in consistent interpretations between IORPs and between Member States • a series of, increasingly sophisticated, QISs would be a much better approach. 	
Q6.	<p><i>Given the purpose of the QIS, do stakeholders consider the proposed simplifications for the valuation of the holistic balance sheet (for the risk margin in section 2.5, sponsor support and pension protection schemes in 2.6 and amounts recoverable from insurance in 2.7) adequate? Do you have suggestions for additional simplifications that would be appropriate?</i></p> <p>The derivation of the number 8% for the Risk Margin 8% is unclear.</p> <p>We question whether the ‘stochastic simplification’ of the valuation of sponsor support is stochastic at all – as the text provides a closed formula solution. We would also want to consider whether the proposed simplifications could go further, since we consider that complex formulae</p>	

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	<p>coupled with what appear to be arbitrary assumptions leads to misleading precision. Some significant testing is needed to see whether appropriate simplifications can be made in order to avoid misleading precision.</p> <p>The inclusion of certain aspects (e.g. recoverables from insurance) seem irrelevant to IORPs and highlights the inappropriateness of cutting and pasting from Solvency II – as the QIS undoubtedly does.</p>	
Q7.	<p><i>The best estimate of technical provisions should be based on the most recent mortality tables including the future trend in mortality rates (Section 2.4). Do stakeholders believe that IORPs will be able to take into account this trend in mortality rates? Can you explain?</i></p> <p>Although the terminology needs further clarification, we expect that in the Netherlands IORPs should be able to meet this requirement.</p>	
Q8.	<p><i>Is it clear enough from the technical specifications what cash flows should be taken into account in the calculation of the best estimate (e.g. in relation to benefits (unconditional, pure conditional, pure discretionary, mixed), contributions, expenses, etc.) and how the projection of these cash flows should be made (Section 2.4)?</i></p> <p>The cash flows to be considered for the best estimate valuation will be clear in the Dutch context, although the stochastic valuation of these cash flows (and in particular the non-unconditional ones) will prove complicated and diverse in nature. Furthermore, we question whether the cost of performing calculations for conditional, mixed and discretionary benefits is commensurate with the benefits of doing so.</p> <p>The cash flows arising from expenses might need more detail. It is our understanding that future expenses should only be taken into account to the extent that they relate to accrued benefits and assuming no future accrual. Based on this assumption, it should be determined what share of overhead expenses relates to the accrual of benefits.</p>	
Q9.	<p><i>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</i></p>	

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	<p><i>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?</i></p> <p>We would consider the approach theoretically interesting and academically justifiable. We question whether the effort in being so mathematically precise here is commensurate with the cost.</p>	
Q10.	<p><i>The technical specifications propose that security mechanisms should be valued on a market consistent basis, i.e. by calculating the probability-weighted average of (discounted) expected payments from the sponsor and the pension protection scheme (Section 2.6). Do stakeholders agree with the principles for the valuation of sponsor support and pension protection schemes? If not, what alternatives would you propose?</i></p> <p>Towers Watson has proposed an alternative and more pragmatic approach on the 11th of June in a letter to Commissioner Barnier.</p>	
Q11.	<p><i>Do stakeholders have suggestions for the parameters- such as the probability of default and the recovery rate in the event of default - used in the valuation of sponsor support and pension protection schemes (Section 2.6)?</i></p> <p>Credit ratings may not always be reliable. Also, different rating agencies may give different ratings to the same sponsor.</p> <p>For industry wide schemes, different ratings may apply, not only for the same sponsor but among different sponsors. A lot more thought is needed as to how to go about this – certainly on the basis that use of credit ratings is inappropriate.</p>	
Q12.	<p><i>Do stakeholders agree with the methodology set out to value the maximum value of sponsor support (Section 2.6)? Do stakeholders have suggestions for the parameters used in valuing the maximum amount of sponsor support? In particular, with regard to the proportions of future profits / EBTDA and the time period of the calculations.</i></p> <p>Our responses to questions 10 and 11 apply here.</p>	
Q13.	<p><i>The draft technical specifications propose performing an upward shift in the basic risk-free</i></p>	

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	<p><i>interest rate curve to approximate the so-called counter cyclical premium or to allow IORPs – under conditions – to apply the so- called matching premium (Section 2.8). Do stakeholders agree with this approach to take into account the long_ term nature of pension liabilities?</i></p> <p>We would argue for an approach that takes movements in interest rate markets into account. An approach that doesn't do this would limit the efficiency of interest rate hedges and could therefore be an incentive for risk management behavior that is suboptimal. It has been argued that this is even the case for the currently proposed design of the Ultimate Forward Rate, which creates unhedgeable basis risks.</p>	
Q14.	<p><i>Do stakeholders agree that the proposed way to derive the level B discount rate adequately reflect the expected return on assets of IORPs (Section 2.8)? If not, what alternative would you propose?</i></p> <p>We appreciate that based on macro-economic considerations, there may be arguments to prefer the level B approach over the level A approach. Other than in other legislations, if the level B approach would come to apply for benefits accrued under Dutch legislation, this would lead to sizeable redistributions.</p>	
Q15.	<p><i>Do stakeholders agree that the draft technical specifications specify a fixed yearly percentage of respectively 2% and 3% for the expected inflation rate and salary growth? Or should IORPs also be allowed to expected inflation implied by financial markets? Could you explain?</i></p> <p>The fixing of these variables is in stark contrast to the highly-detailed approach adopted in other areas of the specification in the name of achieving market consistency. It is unclear why IORPs are not required to set their inflation assumption in a market-consistent way to the extent that market information is available.</p>	
Q16.	<p><i>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?</i></p> <p>It is our impression that in some respects the SCR calculations are too detailed. Some elements that may be relevant to insurers but less so for IORPs could be dealt with more pragmatically or deleted altogether.</p>	
Q17.	<p><i>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</i></p>	

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	<p><i>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?</i></p> <p>We question whether there should be an explicit Risk Margin or whether it should be incorporated within the SCR. If the option is chosen of a Risk Margin based on explicit provision for adverse deviation, then the existence of this margin should be taken into account when determining the stresses within the SCR.</p> <p>Other than the Dutch Required Own Funds calculations (where it is typically considered as non-standard), the SCR currently doesn't take into account inflation risk.</p>	
Q18.	<p><i>Do stakeholders believe that the way the loss-absorbing capacity of adjustment mechanisms and security mechanisms is taken into account in the calculation of the SCR (Section 3.2) is adequate?</i></p> <p>Experience from implementing Solvency II for insurers leads us to conclude that the modular approach which requires three different SCR calculations is complex and expensive. We think it is entirely appropriate that future indexation in the Dutch context (when non-unconditional) has maximum loss absorbing capacity.</p>	
Q19.	<p><i>Do stakeholders believe that the calculation of SCR in the Operational risk module (Section 3.3) is adequate for IORPs?</i></p> <p>Even though the operational risk module is a comparatively small element of the overall SCR, we believe it is 'over-engineered', representing another component pointing to misleading precision.</p>	
Q20.	<p><i>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?</i></p> <p>The application of the benefit option risk sub-module needs to be clarified for IORPs. In particular, it is not clear how benefit options such as commutation of pension for a cash sum at retirement are to be taken into account. The lack of clarity arises because the wording used has been drafted in an insurance, rather than an IORP, context.</p>	

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Q21.	<p><i>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?</i></p> <p>No. In particular we consider that the 50% sponsor support is arbitrary. It fails to capture the multi-dimensional nature of sponsor support and therefore risks substantially misleading results.</p>	
Q22.	<p><i>Do stakeholders believe that the calculation of SCR in the Benefit option risk sub-module (Section 3.7) is adequate for IORPs?</i></p> <p>We suggest that it would be beneficial if this sub-module were re-drafted so that it is directly applicable to the benefit option risks of IORPs.</p>	
Q23.	<p><i>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?</i></p> <p>Our experience with implementing Solvency II leads us to conclude that the ‘basis risk’ requirements are onerous. We also consider that the consultation document fails to recognise dynamic hedging as a valid risk management technique.</p>	
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I.2.5.	Based on our experience with insurers related to Solvency 2, we expect that only the very largest	

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	schemes will be able to provide the information requested in the QIS to the full detail.	
I.2.6.		
I.3.1.	The definition of defined contribution needs further clarification. We expect that, given the description in this article, the proposed new contract type in the Netherlands (the real contracts) should be qualified as defined contribution.	
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I.4.19.	The confidence level is one (important) element that has been taken directly from Solvency 2. A	

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	level lower than 99,5% may well be more appropriate for IORPs, and we welcome the fact that the impact of other confidence levels will also be reported. In responding to the consultation, we would have appreciated some more detail on the method to be developed by EIOPA to reflect the lower confidence levels. We expect this detail will be provided in the QIS.	
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I.6.2.	Although regulatory consequences may be out of scope for the current consultation and the QIS itself, we feel that it is difficult if at all possible for shareholders to judge what the impact of the IORP Directive will be. On a more technical level – future financing as well as (other) regulatory consequences may influence ‘non-unconditional’ elements in a plan, such as in the Dutch situation the future indexation of accrued benefits, as well as the possible reduction of the same benefits.	
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I.11.1	<p>It is our impression that the timescale for the consultation, as well as for the QIS itself and the processing of the findings of the QIS resulting in the revised IORP Directive, is unrealistic. We regret that the consultation period (for a single QIS that is in fact more condensed than any of the five for insurers) has been contracted by 50%. The contents of the consultation seem to indicate that the timescale for writing it has also been strict. Elements taken from Solvency 2 are very (and at times perhaps unnecessarily) detailed, whereas elements that are brought in specifically for the IORP Directive are relatively generic.</p>	
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HBS.4.21.	The cash flows arising from expenses might need more detail. It is our understanding that future expenses should only be taken into account to the extent that they relate to accrued benefits and assuming no future accrual. Based on this assumption, it should be determined what share of overhead expenses relates to the accrual of benefits.	
HBS.4.22.		
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HBS.4.24.		
HBS.4.25.		
HBS.4.26.		
HBS.4.27.	There appear to be complexities arising as to exactly what benefits constitutes an unconditional, conditional, discretionary or mixed benefit. This inevitably leads to considerable scope for different Member States (or, within an individual country, different IORPs) to make their own judgements.	
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HBS.4.37.	The stochastic valuation of these cash flows (and in particular the non-unconditional ones) will prove complicated and diverse in nature. Furthermore, we question whether the cost of performing calculations for conditional, mixed and discretionary benefits is commensurate with the benefits of doing so.	
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HBS.6.17.	The 50% recovery rate seems to be arbitrarily determined.	
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HBS.6.19.		

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HBS.6.21.	We doubt whether it is always clear what part of the contribution relates to existing obligations and should or can therefore be considered additional contributions. We note that the fact that regular contributions aren't referred to in the consultation adds to this lack of clarity.	
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HBS.6.36.	The assessment of future profits and sponsors' earnings seems to be arbitrarily determined.	
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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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	<p align="center">Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II</p>	<p align="center">Deadline 31 July 2012 18:00 CET</p>
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HBS.8.6.		
HBS.8.7.	<p>We would argue for an approach that takes movements in interest rate markets into account. An approach that doesn't do this would limit the efficiency of interest rate hedges and could therefore be an incentive for risk management behavior that is suboptimal. It has been argued that this is even the case for the currently proposed design of the Ultimate Forward Rate, which creates unhedgeable basis risks.</p> <p>We refer to the response by the Academic community group for an alternative that meets our criteria.</p>	
HBS.8.8.		
HBS.8.9.		

	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
HBS.8.10.		
HBS.8.11.		
HBS.8.12.	The 50 bp adjustment to allow for the illiquidity premium seems to be arbitrarily determined.	
HBS.8.13.		
HBS.8.14.		
HBS.8.15.		
HBS.8.16.	We appreciate that based on macro-economic considerations, there may be arguments to prefer the level B approach over the level A approach. Other than in other legislations, if the level B approach would come to apply for benefits accrued under Dutch legislation, this would lead to sizeable redistributions.	
HBS.8.17.		
HBS.8.18.	The indices seem to be arbitrarily determined. It is unclear why only long maturity bond indices are referred to.	
HBS.8.19.		
HBS.8.20.		
HBS.8.21.		
HBS.8.22.		
HBS.8.23.	<p>The inflation assumptions determined.</p> <p>The fixing of these variables is in stark contrast to the highly-detailed approach adopted in other areas of the specification in the name of achieving market consistency. It is unclear why IORPs are not required to set their inflation assumption in a market-consistent way to the extent that market information is available.</p>	
HBS.8.24.	<p>The salary increase assumptions seem to be arbitrarily determined.</p> <p>The fixing of these variables is in stark contrast to the highly-detailed approach adopted in other areas of the specification in the name of achieving market consistency. It is unclear why IORPs are not required to set their inflation assumption in a market-consistent way to the extent that</p>	

	Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II	Deadline 31 July 2012 18:00 CET
	market information is available.	
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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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SCR.7.29.	The longevity shocks seem to be arbitrarily determined.	
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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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