

**Comments Template on  
Discussion Paper on Sponsor Support Technical Specifications**

**Deadline  
31 October 2013  
18:00 CET**

Name of Company:	EAPSPI - European Association of Public Sector Pension Institutions	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> <li>⇒ Do <b>not</b> change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool</li> <li>⇒ Leave the last column <u>empty</u>.</li> <li>⇒ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question, keep the row <u>empty</u>.</li> <li>⇒ Our IT tool does not allow processing of comments which do not refer to the specific numbers below.</li> </ul> <p><b>Please send the completed template, in Word Format, to <a href="mailto:DP-13-001@eiopa.europa.eu">DP-13-001@eiopa.europa.eu</a></b></p> <p><b>Our IT tool does not allow processing of any other formats.</b></p> <p>The numbering of the questions refers to Discussion Paper on Sponsor Support.</p>		
<b>Reference</b>	<b>Comment</b>	
General Comment	<p>The <b>European Association of Public Sector Pension Institutions (EAPSPI)</b>, which covers 26 pension institutions and associations of the public sector out of 16 European countries and speaks for 33 million people throughout Europe, would like to make the following general remarks ahead of the answers in detail:</p> <ul style="list-style-type: none"> <li>I. EAPSPI fully agrees with the aim of the Commission in the Call for Advice of April 2011, according to which <b>a risk-based supervisory system for IORPs should be developed on the basis of the IORP Directive as the starting point</b>. This approach is justified due to the basic differences between IORPs and insurance undertakings, as EIOPA itself has identified several times (i.e. in the previous second consultation document on the review of the IORP Di-</li> </ul>	

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rective, EIOPA-CP-11/006, in particular see 9.3.6 a – h). EAPSPI has reservations that in spite of this commitment, this discussion paper on sponsor support technical specifications as well as EIOPA’s previous consultations on the IORP review is built on the Solvency II principles and structure.

EAPSPI continues to be of the opinion that the supervision of IORPs requires a **regulatory regime sui generis** that truly accounts for the differences of IORPs and insurance companies. Due to the differences of pension schemes all over the EU, EAPSPI suggests to respect those differences among occupational pension systems in the different member states when designing a new regulatory framework.

**II.** EAPSPI welcomes that **EIOPA for the first time mentions non-corporate sponsors, especially public sector entities and charities**, and explicitly recognises the problems of quantifying the sponsor support related to these kinds of sponsors (see No. 64 to 67 and 101 to 102 of the Discussion Paper).

However, EIOPA does not present a solution on how the approach of quantifying sponsor support could be amended in a reasonable and feasible way for not-for-profit-institutions and especially for public sector IORPs.

EAPSPI is of the opinion that EIOPA’s simplified alternative approach cannot be made workable for public sector IORPs as the basic notion to take some already available information out of a standard financial statement and to calculate two credit ratios does not fit in case of public sector and not-for-profit entities.

**III.** Bearing in mind the details of the HBS as presented in the QIS of 2012, EAPSPI is of the opinion that the **purpose of the HBS** is two years after its presentation to stakeholders still not clear:

- (1) Does the HBS “only” have a “**soft**” **informational character** in order to foster transparency, measuring and comparability of security mechanism of IORPs, as was mentioned several times from EIOPA (since the consultation document from October 2011 and EIOPA’s advice to the Commission in February 2012)?

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- (2) Is the HBS meant to be a **"hard" supervisory tool** – this perspective was also mentioned by EIOPA – supposed to **automatically trigger consequences** in terms of higher solvency capital charges for IORPs and supervisory actions?

Given this uncertainty, EAPSPI would like to emphasise that

- commenting on the HBS is difficult;
- the intention and the application of the HBS, particularly the regulatory consequences, should be clarified in advance of answering questions of detail of the HBS;
- if the HBS is to be used for measuring and comparability only the question remaining is why to cause such effort and extra costs to IORPs in order to implement the HBS;
- if the HBS is used to trigger regulatory actions the question remains in what way regulatory action should be taken in case of a shortfall within the HBS since all security mechanisms (sponsor support, pension protection schemes, benefit reductions) are already included.

**IV.** EAPSPI therefore expresses its **general concern with the HBS** as presented in the IORP QIS of 2012. As the actual discussion paper (as well as earlier consultations e.g. on the technical specifications of the QIS) does not offer the possibility to address this general issue, EAPSPI sketches its general reservations about applying the Solvency II principles, the SCR structure and the HBS concept to IORPs. It would not be possible to answer EIOPA's question in the discussion paper on the details of the sponsor support without being able to refer to this argumentation.

- The **Solvency II regime is not necessary for IORPs**. The already existing security mechanisms have proven to be safe during the past crisis.
  - IORPs have specific **inbuilt security mechanisms** that ensure the solvency position

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of pension schemes. In some pension schemes, contributions and the main benefit parameters can be modified by the employers and the employees' representatives.

- Many pension schemes, especially of the public sector in the Netherlands, Scandinavian countries or in Germany, foresee **paritarian management**. Paritarian management involves social partners on the Board of Directors of the IORP or in similar internal supervisory bodies. Due to paritarian representation, the interests both of the employers and of the employees and beneficiaries are well-balanced and the benefit security can therefore be ensured.
- Due to the fact that IORPs in the public sector are **social institutions** and therefore not chiefly for profit organizations, the possibility of a potential conflict of interests between member protection and profit maximizing behavior and dividend payments is minimised.
- For DB- and hybrid DB-/DC-schemes, in at least some Member States, **employers have the ultimate responsibility to fulfill the respective pension commitment**
- **The structure of Solvency II is not appropriate** for the regulation of IORPs due to the differences between IORPs and insurance undertakings. Because of the long-term nature of pensions, the actual risks IORPs are facing differ from those of insurance undertakings. Indeed the stable and long-term character of IORPs' liabilities has various risk mitigating effects. The methods of measuring and quantifying financially the risks of IORPs as laid out in Solvency II do not meet the nature of IORPs. These aspects should be taken into consideration when redesigning the regulatory framework for IORPs.
- The HBS and the calculation of the SCR in the draft specifications fully rest on the Solvency II structure of measuring and quantifying risks which EAPSPI regards as inadequate for IORPs. By maintaining this structure, the **HBS itself is not an appropriate**

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**approach for IORPs.** The fact that security mechanisms of IORPs are considered at a later stage may not solve this general problem.

- Additionally EAPSPI is of the opinion that the **HBS is not appropriate** to reach the intended goal of the European Commission namely **to precisely assess and quantify the “true risk position” of IORPs** (CfA 4.1 from March 2011), because of the design and the valuation of the HBS. The valuation methods specified for the QIS still involves a high degree of arbitrariness and leads to pseudo-certainty which contradicts the notion of a neutral, objective and informative balance sheet. This problem arises in case of the various suggested ways of quantification: Stochastic modelling strongly depends on the (often arbitrary) choice of parameters and models which make results hard to compare. With respect to the (simplified) deterministic valuation approaches it is not clear if the suggested simplifications are appropriate or even incorrect. Therefore, the results of stochastic modelling and the simplified deterministic approaches are not comparable. This task becomes even more complex when it comes to evaluating the financial soundness of a public sector institution as employer and sponsor.
- Furthermore, the HBS leaves room for what could be named the **“Holistic Balance Sheet Paradox”**: The security level for the employees is the same as without the HBS, economically speaking nothing changes, but - with the HBS - costs increase dramatically. The existing security mechanisms today already safeguard at a low cost exactly the same level of security which would be created with so called quantitative precision in the new regulatory regime for a much higher cost (best case) if not for the price of termination of existing pension scheme arrangements (worst case).
- As a conclusion, given the quality of the various existing security mechanisms of IORPs and the problems of a precise quantification and risk assessment for IORPs and their security mechanisms, EAPSPI argues for not implementing the HBS because the security mechanisms of IORPs as “holistic assets” deliver a flexible insolvency protection and make up for truly exceptional cases that should release IORPs from a Solvency II-like risk-

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	based regulatory regime.	
Q01.		
Q02.		
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Q04.		
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Q31.		
Q32.		
Q33.	<p>EAPSPI welcomes that <b>EIOPA for the first time mentions separately non-corporate sector sponsors, especially public sector entities and charities, and explicitly recognises the problems of quantifying the sponsor support related to these kinds of sponsors</b> (see No. 64 to 67 and 101 to 102).</p> <p>But <b>EAPSPI is sceptical if the presented alternative approach on how to assess the strength of the sponsor support via two credit ratios for profit-oriented corporations (income cover and asset cover) can also be suitably amended for not-for-profit-employers and particularly for public sector entities</b>. EIOPA does not present a solution on how the approaches for quantifying sponsor support could be amended reasonably for not-for-profit-institutions and especially for public sector IORPs. Although EIOPA states (No. 65) that it is possible to apply the principles of the simplified approach for profit-oriented corporations also to specific situations of charities and public sector entities, no concrete suggestions of how to do so can be found:</p> <ul style="list-style-type: none"> <li>- EIOPA mentions with respect to <b>charities</b> that given the <i>“specific credit features of charities (e.g. generally no target to generate surplus income), it may be appropriate to relax the income cover metrics as compared to a corporate sponsor”</i> (see No. 66 and No. 101). EAPSPI is of the opinion that it will be rather challenging to discover a serious (data) base for the deduction of how much relaxation is appropriate (i.e. to develop an adjusted</li> </ul>	

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credit ratio matrix for not-for-profits analogue to table 4 on page 24). Valid data on default probabilities for not-for-profit entities seems to be lacking. If no serious deduction is possible, the procedure as a whole becomes questionable.

In addition, there is doubt that financial ratios for not-for-profit entities have the same explanatory power as those of profit-oriented corporations. Therefore, the output of the simplified alternative approach for not-for-profit entities might not be comparable with the output for “normal” profit-oriented corporations.

- With respect to **public sector sponsors** EIOPA provides an indistinct impression (No. 67 and No. 102) on how the credit quality of the public sponsor may be assessed using the credit ratios analogue to the income and the asset cover ratio. EIOPA mentions as determining factors for the credit quality *“the size and stability of its [the sponsor’s] income”* and *“the degree of control over its costs and its financial flexibility to cope with revenue shortfalls and cost increases”* as well as (central) government grants or commitments. **A thorough assessment of these mostly very complex financial arrangements and safeguarding mechanisms of many public sector entities is time-consuming and can hardly be handled while the approach itself is already questionable** (e.g. an attempt to precisely qualify). Especially multi-employer public sector IORPs will face obstacles; see also Q34. For example, a German public sector IORP with municipalities as sponsors would have to assess the structure and the various dimensions of the revenue equalisations in Germany, that organises the financial distributional system between the different administrative levels: municipalities, federal states, federal level. This system involves a distinction between the primary and secondary revenue equalisation (the formal allocation of proportions from certain tax revenues vs. hardship case adjustments) as well as between the horizontal and the vertical revenue equalisation (from one municipality/state to another municipality/state vs. from the federal state to the states or from the states to the municipalities). The German system of revenue equalisation is very complex and a thorough assessment as suggested by EIOPA (No. 67 and 102) is unworkable in practice.

**Therefore, EIOPA’s proposals for public sector IORPs at current state does not provide a feasible**



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basis. EAPSPI is of the opinion that EIOPA’s simplified alternative approach cannot be made workable for public sector IORPs. The basic notion to take already available information out of a standard financial statement and to calculate two credit ratios (see No. 51) does not fit in the case of public sector entities.

EAPSPI recognises that the presented alternative simplified approach for the calculation of the sponsor support facilitates the valuation. However, **EAPSPI finds that even with respect to the simplified approach the valuation of sponsor support is still too complex particularly for public sector IORPs which are predominantly multi-employer IORPs** involving mostly large numbers of sponsors. Applying the procedure even of the simplified approach would require to collect the numbers for the two credit ratios, asset cover and income cover; to determine reasonable payment periods; to calculate the loss absorbing capacity and to perform sensitivity analysis – for all sponsors/employers. This procedure is very time-consuming and costly for multi-employer IORPs. For example, the supplementary pension scheme for public employees in Bavaria covers 5,500 employers and the supplementary pension scheme of the German Catholic Church 8,700 employers. The total number of pure public sector employers in Germany sums up to around 26,000 employers covering a huge variety of employers.

Multi-employer IORPs by nature are not exposed to a “single” default risk (i.e. all sponsors defaulting at the same time) and EIOPA recognises consequently (see No. 106) that the calculation / separation of liabilities for each employer in case of the “last man standing” arrangement of the IORP is quite complex and laborious. These aspects must be taken into account in case of multi-employer IORPs and public sector IORPs.

The question arises if the suggested alternative approach is *suitable at all* for not-for-profit or public employers and if it is appropriate to evaluate the financial solidity and the credit strength of these sponsors by calculating two standardised credit ratios developed for private profit-oriented corporations.

Q34.

Q35.

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Q36.