	Comments Template on EIOPA-CP-11/001 **Draft response to Call for Advice on the review of Directive 2003/41/EC** ***Scope, cross-border activity, prudential regulation and governance***	**Deadline** **15.08.2011** **18:00 CET**
Company name:	Mercer Limited Contact: Deborah Cooper, Mercer Limited, Tower Place West, London, EC3R 5BU, UK deborah.r.cooper@mercer.com	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. Please indicate if your comments on this CP should be treated as confidential, by deleting the word Public in the column to the left and by inserting the word Confidential.	Public

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- ⇨ Do **not** change the numbering in column "Reference".
- ⇨ Please fill in your comment in the relevant row. If you have no comment on a question, keep the row empty.
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The question numbers below correspond to Consultation Paper No. 01 (EIOPA-CP-11/01).

Reference	**Comment**	
General Comment	Mercer is a leading global provider of consulting, outsourcing and investment services. Mercer works with clients to solve their most complex benefit and human capital issues, designing and helping manage health, retirement and other benefits. It provides benefits, actuarial, investment and governance	

consulting advice to IORPS throughout the European Union and is a leader in benefit outsourcing. Its investment services include investment consulting and multi-manager investment management.

In this context, Mercer understands the importance of IORPs, both in relation to providing income to scheme members when they retire from work and as major investors as a class and, in some cases, as individual schemes. Those countries with material defined benefit pension provision have witnessed declining levels of provision, and its replacement with defined contribution schemes, as additional regulation has been imposed. So, although some regulation is absolutely necessary, for example to ensure scheme members understand the risks they carry, the wrong sort of regulation can increase those risks.

In particular, what supervisory authorities can achieve is limited – in many cases an entity separate from the IORP will be responsible for setting its objectives, including determining its structure. Although regulation such as that proposed in the Call for Advice can ensure that, within these parameters, processes are well managed, it does not ensure that the original objectives remain fit for purpose. It is not the responsibility of supervisory authorities to set objectives for individual IORPs, but the way regulation is established and enforced can result in some arrangements becoming preferable to others, regardless of how appropriate they are for the intended membership. In that case, no matter how well run those IORPs are, the outcomes will be unsatisfactory.

Regulatory authorities must walk a fine line between imposing regulations that enable IORPs to operate well and regulations that result in their objectives and purpose being undermined.

The fine line applies to the type of regulation imposed and the extent of regulation and regulatory oversight. There is a real danger in believing that more regulation necessarily creates additional security: in our view this is not the case. Regulation needs to be risk based and proportionate and implemented in a reasonable way. Otherwise, its cost could undermine the provision it is trying to protect. So, for example, although it seems beneficial for regulatory authorities to have wide powers to access IORPs' premises and those of their service providers, and to demand data and other information, in some cases this will be disproportionate, sometimes to the extent that regulation will be duplicated. Similarly, where services are provided by individuals or entities that are separately regulated (by a regulatory authority the

IORP's supervisory authority should recognise), the IORP's supervisory authority should be able to rely on that regulation rather than enforcing its own regime.

It is critical, in our view, that revisions to the IORP Directive aim to ensure, as far as possible, that local regulators can operate effectively, to support the development of robust retirement provision in member states.

We consider that all retirement saving established by employers, and (partly) paid for by them, on behalf of their employees should be subject to the IORP Directive. This is regardless of:

i) How, or whether, the IORP is 'funded', since the choice of financing method (although, once the choice has been made, not necessarily the financing itself) is a matter for the employer and should not materially affect the outcome as far as the employee/member is concerned; and
ii) How the underlying benefits are calculated – that is, whether they are considered 'defined benefit' or 'defined contribution', however these terms are defined.

However, we would expect the Directive to be sufficiently flexible that its provisions can be adapted appropriately, depending on the way the IORP is established and/or the benefits provided.

The other overarching point we would like to make refers to the wide range of organisations through which pension benefits within the EU are provided (including those in and those out of the scope of the current IORP Directive). EIOPA refers to this in its draft response to the Call for Advice, but we consider that it should be more strongly reflected in the advice it proposes to give to the Commission. The entities that are subject to the Directive include profit making and not for profit entities; joint stock or limited liability companies and mutual organisations; and insurance arrangements and trust based organisations. Their legal personality varies considerably, not only because each member state's legal framework will differ, but because each structure imposes different regulatory requirements and responsibilities on the organisations' executive and non-executive boards.

EIOPA will be aware of the difficulty local regulators are having implementing Solvency II in relation to insurance companies, which form a small and relatively homogeneous group when compared to pension providers. Revisions to the IORP Directive, whilst respecting the need to ensure that members' expectations are properly respected and delivered within each form of arrangement, must take these

	differences into account. In doing so, EIOPA should ensure that plurality of provision and benefit design is not undermined by its proposals.	
1.	Yes. However, we feel the distinction between social security related pension schemes and employer related pension schemes remains unclear, largely because different member states choose to provide the former in different ways. For example: ▪ In some countries, Pillar 1 provision is financed out of general taxation, whereas in others it is financed (sometimes only notionally) using a tax on labour. ▪ In some countries Pillar 1 provision is funded, or partially funded, whereas in others it is provided on a PAYG basis. ▪ In some countries Pillar 1 provision is provided solely by the state, whereas in others private sector providers are involved. The need for regulation should be governed by the degree of security individuals expect in relation to their accrued rights and entitlements, not necessarily because of the way governments choose to collect tax. So, we support the proposal that, where private sector providers are involved and there are no government guarantees, there should be some regulation of how social security is provided. However, we are less certain that the IORP Directive is the right place for this regulation, since the objectives of social security arrangements are fundamentally different from those of employer provided provision. In particular, we do not agree that social security arrangements should be caught by the IORP just because they are financed out of employment related contributions.	
2.	We consider that the effect of the IORP should not be limited to funded arrangements. Because of local tax or regulatory regimes, some employers establish occupational pension schemes and choose to finance their liabilities using a pay as you go (PAYG) or book reserve model. In our view these are not fundamentally different to funded occupational pensions schemes – the only differences are that the underlying risks and the incidence of cost are distributed differently. However, although we think that unfunded arrangements should be brought into the scope of the IORP Directive, we do not suggest it is necessary to impose (for example) funding rules on unfunded schemes. Instead, the IORP Directive should recognise that different mechanisms can be used to achieve the appropriate level of financial (and other forms of) security targeted for IORPs. For example, if schemes	

	are provided using PAYG financing, then the underlying risks could be underwritten in different ways. Extending the IORP Directive in this way would achieve a more level playing field than the current regime, or than the options EIOPA has currently included in its draft response.	
3.	We prefer the intention behind Option 4, which we view as a version of Option 2 - that is, by extending the scope of the IORP, the European Commission will clarify what should be considered an occupational pension scheme. However, we are not convinced that Option 4, as set out in the draft response, achieves this. In particular: ▪ Unfunded schemes should be included in the 'clarification'; ▪ The status of schemes provided by public authorities acting as employers should be clarified. In principle, we would have preferred Option 5, if this were limited to those personal pension schemes established by employers, who then contribute on their employees' behalf. However, these are currently subject to insurance company regulation and to apply both sets of regulation would be excessive.	
4.	In our view, it should be possible to distinguish between benefits an individual becomes eligible to receive because they are employed, and those they are eligible to receive because they are employed by a particular employer. In terms of pension benefits, the former would include any state pension where entitlement depended on working history of any sort; the latter would include benefits that could only accrue in employment with the employer. In that case, if contributions are compulsory, we would distinguish between two sorts of arrangement: ▪ Those where decisions made by the employer cannot affect the level of benefit that will be paid in lieu of the compulsory level of contributions; and ▪ Those where the employer can choose the provider and/or the benefit structure and, in doing so, potentially affect the level of benefit that could become payable. In our view, the former remains a 'social security scheme' whereas the latter does not and so should be within scope of the IORP Directive.	
5.	We do not consider the analysis to be complete and would add the following negative impact:	

	▪ The majority of cross border schemes are in countries (Ireland, the UK, Belgium and the Netherlands) that have not adopted the proposed regime, so making a change is likely to create substantial disruption. We would also point out that there are several reasons why it is not sensible to assume the number of cross border schemes should be comparable to the number of IORPs overall, apart from perceived weaknesses in the IORP Directive: ▪ The majority of IORPs are in relation to small employers who have no interest in cross border provision; ▪ Frequently, IORPs in different member states are established in ways that tax authorities in other member states do not recognise for the purpose of providing tax relief on pension contributions, for example. In some cases, this makes it less attractive to adopt cross border provision.	
6.	If the objective is to adopt the regime proposed, then no. If the objective is to find a regime that enables employers to operate a single cross border scheme that is able to respect the relevant local provisions of its employees, then yes. The Annex to the European Commission's Call for Advice says (para 2.3) that its intention is to enable an undertaking in one member state to sponsor an IORP in another member state. This seems clear, but we wonder to what purpose? The majority of undertakings will have no interest in this option. Those undertakings that are likely to have an interest are those where, either directly or through subsidiary or branch organisations, they have employees located in different member states. Then, the intention will be to establish a single scheme that employees resident in other member states (for legal purposes) are able to join. This could be the case regardless of whether the undertaking is based in a member state or outside the EU. Our view is that the current definition of host member state achieves this, by implicitly referencing the legal residential status of the employee, rather than the employer. If it is unclear in that respect, then our preference would be for this to be clarified, rather than for it to reflect the employer's status. Previously we have understood that prudential regulation, as applied to occupational pension schemes, is	

	instituted to ensure that the provision of members' accrued benefits and entitlements is appropriately regulated. The proposal made by the Call for Advice seems to be to provide a potential advantage to employers' based in the EU. In our view, legislation to promote employers' activities is likely to sit uneasily within legislation largely intended to regulate occupational pension provision.	
7.	See answer to 6 above.	
8.	Employers establish pension arrangements for employees that reflect the social and labour law that the employees are subject to, not the social and labour law relevant to the location of the employer. So the provisions in Article 20 seem to us to make more sense if the 'host member state' for the sponsoring undertaking is associated with the legal residence of the employees, rather than the undertaking's location. The additional procedures suggested here largely seem to be needed because the original intention – which is to consider the location of the employer rather than the employee – is flawed and leaves gaps that will continue to undermine the effectiveness of any cross border provision. In our view, the IORP Directive should consider member interests in establishing the rules that underlie cross border provision: that is, it would be preferable to institute a regime that provides appropriate protection to scheme members' benefits, regardless of where the scheme is located, whilst respecting the social and labour law members are subject to because of the member state they are legally resident in. The location of their employer seems irrelevant to this.	
9.	The options presented, to do nothing, or to define the scope of prudential regulation, seem complete and we agree with the analysis.	
10.	See answer to question 9.	
11.	We broadly agree that the approach taken under Option 2 could bring greater clarity but, on the basis of the information provided, we are unclear about how it will be implemented into the IORP Directive and at the local level. If Option 2 results in a definition of prudential regulation as including the requirements set	

	out in the relevant Articles of the Directive, then that seems clear; however, if (as implied by paragraph 8.3.5) the definition is just 'the regulation administered by the Home member state' then the definition becomes circular and no purpose will be served.	
12.	Because the relationship between occupational and state provided retirement benefits varies in each member state, there will always be inconsistencies between each country's prudential regulation and social and labour law. Where there are overlaps, in the case of cross border schemes it would be helpful if there were procedures that clarified whether the Home or Host member state's provisions must be met. However, rather than imposing a prescriptive regime, which could undermine existing provision, EIPOA could facilitate how the supervisory authorities in different member states resolve any differences in treatment. For example, making clear that the supervisory authorities in each member state relevant to a cross border scheme are responsible for resolving any differences in local legislation, with EIOPA acting as facilitator to the process by which they carry out this responsibility, would give those entities wishing to establish cross border schemes greater certainty and so reduce one of the main obstacles to their establishment.	
13.	In principle we support the application of strong governance principles to IORPs and, provided the principle of proportionality is applied appropriately, agree that the general requirements on undertakings included in Article 41 of Directive 2009/138/EC, as modified by EIOPA in the proposed advice set out in paragraph 10.4 of the draft response, should not prove onerous. In determining what is proportionate, EIPOA should take the following matters into account: ▪ Directive 2009/138/EC applies only to insurers and reinsurers with more than Euro 5 million gross premium income: the IORP Directive applies to all schemes with 100 or more members, and so includes far smaller operations. Consequently, we suggest that as well as applying proportionately to the requirements imposed on IORPs, the powers available to national regulators should also be exercised proportionately. In particular, paragraph 5 of Article 41 should be modified so that	

supervisory authorities can only make reasonable demands of scheme managers when carrying out their duties. By this we mean that:

- The scale of information provided should be appropriate and not impose onerous burdens on those that run IORPs; and,
- Apart, perhaps, from basic information which it might be necessary to update regularly, it should only be requested for a particular purpose, for example, when a new risk has been identified in relation to the IORP.

Apart from that, we feel that, in many cases, supervisory authorities should be able to rely on self-certification of processes by those responsible for the IORP. Alternatively, where the processes have been introduced following advice from an individual or entity already subject to regulation, the IORP's supervisory authority might be prepared to accept certification from the regulated individual or entity.

However, 'proportionality' needs to take risk into account as well as size. There could be some circumstances where it is not reasonable to subject smaller IORPs to lighter regulation, in which case, if the regulatory burden is perceived as onerous, member states should consider whether the delivery model selected by the IORP is fit for purpose. Enabling alternative structures that create the economies of scale necessary for strong risk management and governance (for example, creating federations of smaller IORPs under a common governance structure) might meet the objectives underlying the Directive better, as well as achieving better member outcomes.

- IORPs are established and managed using many different models, whereas a smaller number of legal structures apply to insurance companies. The IORP models are often specific to a member state, so when considering the Level 2 application of the high level principles likely to be established in the amended Directive, EIOPA should refrain from prescription, perhaps doing little more than reiterating the principles that need to be complied with. The detail can then be set at a national level, with EIOPA having oversight to ensure that consistency is achieved.

  The different structures are likely to mean that various different forms of remuneration policy will emerge, so we welcome EIOPA's recognition that the special characteristics of each IORP should be taken into account when determining what is required.

	We also agree that written policies in respect of, for example, internal controls, audit, outsourcing and remuneration, should be required and regularly reviewed (where 'regularly' could depend on the nature of the IORP). Although we agree that policies should not be required where they are irrelevant (for example, a remuneration policy when there are only volunteer staff), if staff are employed indirectly (for example, by the employer) we consider that a policy should still be expected. In particular, given that conflicts can exist between the IORP and the sponsoring employer, in these cases the policy might be more necessary to ensure that the employees' interests are appropriately aligned. However, when (as mentioned, for example, in paragraph 10.2.7) respondents to the Green Paper on pensions suggested that some features of pillars 2 and 3 of Solvency II could usefully be applied to IORPs, we expect that it was the concepts that were considered applicable rather than their detailed application. Although there is clearly value in each of the 'governance' related principles discussed in chapters 12-15 of the Call for Advice, we do not agree that the relevant provisions in Directive 2009/139/EC should necessarily be transferred word for word into the IORP Directive. What is important is that the Directive enables local regulators to be effective in applying governance related principles in way that support the development of robust retirement provision in each member state.	
14.	Similarly to our answer to question 13, it seems reasonable to require those with control over the way an IORP is managed or administered to meet 'fit and proper' criteria, regardless of whether the benefits provided are defined benefit or defined contribution. Whilst agreeing that some level of knowledge and understanding is essential, we are less concerned that they have necessary qualifications. Often, having a range of diverse skills and backgrounds on a governing body, rather than a narrow group of 'experts', creates an environment that is more likely to challenge the status quo, so we consider the existing provision in Article 9, which permits those running the scheme to rely on advisers, to be adequate. Where an IORP's management relies on advisers to support it to make key decisions, it seems appropriate that the 'fit and proper' test should apply to those advisers, and the senior management in those advisers' firms, as well as the requirement for appropriate qualifications and experience.	
15.	Mercer agrees that all IORPs should have internal controls and that these should cover outsourced activities, including looking through to the internal controls of the third party. There are also other activities	

	and functions they could cover, which are likely to vary according to the nature and size of the IORP. Because of the variety of ways IORPs are provided throughout the EU, there is a danger that being over prescriptive in what the internal controls should cover or trying to suggest some of the matters to be taken into account could have unintended consequences. Generally our preference is for legislation, particularly at the high level of a European Commission Directive, to be principles based and not to include directions that could be inappropriately interpreted either as rules or as an exhaustive list. We also agree that the effectiveness of each IORP's management and internal controls should be monitored to ensure their processes are effective and compliant. However, in many cases we expect the statement in paragraph 12.2.5, that monitoring should be 'part of daily activities' might be excessive – instead we consider that it should be engrained in each IORP's operation whilst recognising that the size of many means that there might not be any activities from day to day. To this end, we welcome the flexible approach proposed in the draft response, in paragraph 12.3.16. We expect that in the majority of cases it would be disproportionate for an IORP to employ a compliance officer directly, but agree that some measures need to be in place to ensure management and processes are regularly reviewed. For example, in some cases this function might be shared between the IORP's advisers, given to the IORP's (internal or external) auditor, or outsourced to a particular adviser or third party. Similarly, permitting the supervisory authority 'at all times' to require reports from an IORP seems disproportionate – we suggest the requirement is limited to all times when it is reasonable to make such a request and that the request should always be proportionate. In most cases we expect it would be sufficient to rely on occasional self-certification by the IORP or its advisers. We do not think that supervisory authorities should necessarily control the way each IORP establishes its compliance function, provided appropriate steps are taken. For the role to be effective, it needs to be clear that the appointment is in relation to the IORP's governance function and not in relation to the supervisory authority. In any case, each authority should be able to find out how effective the function holder is, through regular disclosures in relation to the IORP's operation. We expect difficult situations will arise that put any individual with a compliance role in a conflict between responsibility to the supervisory	

	authority and to the IORP's management, for example, when internal controls have broken down. In those circumstances, the compliance function should be able to work constructively with the IORP's management to ensure that processes are strengthened and any errors are rectified, but, if an individual is perceived to be acting for the supervisory authority this might become difficult. A balance could be achieved if supervisory authorities establish guidance about how the compliance function should operate where, for example, there are weaknesses in regulatory controls within an IORP, including the circumstances in which problems can be solved without necessarily involving the supervisory authority and the need for conflict of interest protocols.	
16.	Our observations and concerns in relation to the compliance role apply equally to the internal audit function. In particular, where there is already an external audit in most cases we expect this should be sufficient.	
17.	We agree that there could be some advantage if the regulatory requirements for service providers were made more clear. However, similarly to our previous comments, although we agree supervisory authorities should have access to premises and to data, they should be required to exercise these rights in a proportionate way and only where reasonable to do so. EIOPA should also consider how it will treat cases where the entity providing third party services to the IORP is separately regulated, perhaps by EIOPA itself under the Insurance Directive. In that case, it should be possible to look through from one set of regulation to the other, to minimise the risk of regulatory overload. We agree also that it should be possible to apply similar levels of regulatory oversight to outsourcing companies regardless of where they are located, or whether the service company provides the outsourced service directly or sub-contracts it. However, to avoid duplication, where third party providers are based in other member states, the supervisory authority in the member state where the IORP is located should be required to recognise the regulation of the supervisory authority in the member state where the third party provider is based.	

18.	We agree with the principle that IORPs should be permitted to outsource most aspects of their management to third party providers whilst retaining the responsibility for ensuring any functions are provided effectively. We are a bit concerned by Article 49 (2)(c) in the Solvency II Directive and the statement in 15.3.6, that outsourcing 'cannot hinder the exercise of an effective supervision by Supervisory Authorities'. Although clearly service providers should not be appointed with a view to avoiding supervision, in our view, the prime consideration should be that outsourcing cannot hinder the effective running of the IORP – provided this is the case, then Supervisory Authorities should be able to organise themselves to operate effectively in relation to any third party arrangements. The compromise that EIOPA has suggested in its proposal 3(c) seems to achieve this. However, we do not understand the need for IORPs to notify supervisory authorities in a timely manner, of any decisions taken with respect of outsourcing. We expect supervisory authorities will become aware of this through normal disclosure requests and requirements, and that should be sufficient. In relation to the drafting options regarding the role of the supervisory authority, as before we suggest that supervisory authorities' ability to request information is limited to cases where it is reasonable for them to do so and that the information they are able to demand is proportionate.	