

Comments Template on EIOPA-CP-11/006 Response to Call for Advice on the review of Directive 2003/41/EC: second consultation		Deadline 02.01.2012 18:00 CET
Company name:	BARNETT WADDINGHAM LLP	
Disclosure of comments: Public	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. <i>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.</i>	Public
<p>The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006).</p> <p>Please follow the instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <u>Do not change the numbering</u> in column "Question". ⇒ 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>. ⇒ There are 96 questions for respondents. Please restrict responses in the row "General comment" only to material which is not covered by these 96 questions. ⇒ Our IT tool does not allow processing of comments which do not refer to the specific question numbers below. <ul style="list-style-type: none"> ○ If your comment refers to multiple questions, please insert your comment at the first relevant question and mention in your comment to which other questions this also applies. ○ If your comment refers to parts of a question, please indicate this in the comment itself. <p>Please send the completed template to CP-006@eiopa.europa.eu, in MSWord Format, (our IT tool does not allow processing of any other formats).</p>		
Question	Comment	
General comment	Barnett Waddingham LLP welcomes the opportunity to respond to EIOPA regarding its consultation paper on its draft advice to the European Commission.	

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	<p>We are the largest actuarial independent partnership in the UK, and are wholly owned and managed by our 50 partners. Our core business is the provision of actuarial and investment consultancy services to pension scheme employers and trustees, as well as administration and pension scheme management services.</p> <p>Overall we are concerned that the proposals will impact adversely on the UK private sector pension system and, contrary to the EU's aim, could lead to reduced security and reduced retirement income for many. Our response concentrates on the points regarding security and funding of defined benefit occupational pension schemes that we believe are most important.</p>	
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12.	<p>We <u>do not</u> support the "holistic balance sheet" proposal for a number of reasons and believe it could have significant adverse consequences if implemented in the UK. We also believe that the distinction between the two types of IORPs should be retained.</p> <p>There are fundamental differences between insurance companies and IORPs; defined benefit occupational pension schemes were not designed to be funded to insurance company levels and are not run on a competitive or profit making basis. In addition, benefits can be changed post retirement (e.g. discretionary benefits can be granted or the "shape" of benefits can be changed) as well as pre</p>	

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retirement.

Employers that sponsor pension schemes support those schemes by making funding contributions as and when it is required and in accordance with legislative requirements. IORPs are also often significantly smaller than insurance companies. It is crucial to appreciate that while a scheme sponsor remains in business and solvent, benefits are paid out in full and under-funding of pension schemes does not impact on benefits. If a sponsor runs into financial difficulty and ultimately becomes insolvent and if sufficient assets cannot be recovered for benefits to be purchased with an insurance company, then the UK Pension Protection Fund (PPF) will pay compensation to the pension scheme members. The existence of the PPF means that it is not necessary, and not appropriate, for sponsor-backed IORPs to be treated in the same way as Article 17 (1) schemes and we note that we do not believe the PPF is failing to meet its objectives.

Insurance companies, on the other hand, are competitive with each other, they are run to make a profit and cannot rely on additional funding once a contract has been written. Benefits are also fixed at the point the contract is written. It is therefore entirely reasonable (indeed vital) that insurance companies and IORPs are legislated for separately, to reflect their fundamental differences in nature.

We believe that were the "holistic balance sheet" proposal to be implemented, then this would lead to future benefit accrual being reduced in many more cases and many more defined benefit schemes being closed completely to future accrual, ultimately leading to potentially lower pension provision at retirement for the current workforce (typically employers replace defined benefit accrual with a defined contribution arrangement at a lower level of cost). It would also be likely to lead to increased contributions being required from many employees, which could be unaffordable for some.

Further, the dramatically increased funding burdens on sponsors in respect of already accrued liabilities could ultimately lead to a number of employer insolvencies (as capital that could be better used elsewhere in the business is directed to the pension scheme instead), which would inevitably lead to more pension scheme members receiving compensation from the PPF. Overall security of benefits is therefore diminished for those members of pension schemes who are impacted in this way.

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Employer covenant is already taken into account in the actuarial advice on deriving assumptions, for funding purposes. However we note that assessing employer covenant can be extremely complex and by definition is a subjective exercise which is carried out at a point in time. In many cases, it can be a relatively expensive exercise to complete. In our view therefore, a requirement to place a monetary value on such an assessment is unlikely to be beneficial and worse still, could be potentially misleading. Indeed past performance of credit rating agencies has proved that it can be extremely difficult to form meaningful external assessments of an entity's financial strength (especially at times when they are most needed). We do not therefore support a requirement to quantify sponsor covenant in this way and believe it will serve to increase costs and management time for businesses unnecessarily.

A further concern with the proposal is regarding the use of the risk-free discount rate, which we believe is inappropriate, unaffordable and unnecessary. This would be likely to lead to a net disinvestment from equities which could lead to further falls in the equity market. Also, demand for bonds would be likely to increase which would, in turn, lead to lower bond yields and therefore further increased liability values and yet more financial strain for employers. This would also adversely affect other investors including those with Defined Contribution pension schemes.

Our final concern is regarding the discrepancy between the treatment of funded sponsor-backed IORPs and book reserve systems. It does not seem fair that the proposed measures exclude book reserve and "pay as you go" schemes and indeed it seems like this would encourage more book reserve schemes and fewer funded IORPs, thereby defeating the aim of increased security for members.

In summary, in our view the holistic balance sheet approach could have negative financial consequences for many financially strong UK employers and could be just as damaging as Solvency II applied to pension schemes. We do not believe there is any justification for treating sponsor-backed IORPs and Article 17 (1) schemes (two fundamentally different types of scheme) in the same way and if this is what "harmonisation" means then we do not support harmonisation.

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14.	We would support Level B technical provisions (i.e. using an interest rate based on expected asset returns) as a funding target. Level A technical provisions should be used for disclosure only. The concept of transfers of liabilities to insurance companies here is redundant and unduly burdensome.	
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17.	We do not support the "best estimate" funding requirement, as defined by EIOPA. As explained in our response to question 12, we believe that for sponsor-backed IORPs the calculation of technical provisions should be able to allow for expected long term asset returns (with prudent margins).	
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20.	We agree that best estimates of IORPs should be calculated using the gross benefits. We also agree that generally IORPs should be valued in totality first and then assets offset separately (subject to proportionality). For example, reinsurance contracts such as bulk annuities or longevity swaps should be treated as an asset and should be valued on a market consistent basis (i.e. not a surrender value basis). We also note that where special purpose vehicles (SPVs) are set up for pension scheme funding purposes, then the stream of future cashflows ring-fenced from the SPV to the pension scheme should be recognised as an asset for scheme funding purposes.	
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40.	<p>A new minimum capital requirement is unwarranted and will not add any benefit for pension scheme members. There are already several pension scheme funding-based triggers in place (set by the UK Pensions Regulator) for monitoring schemes. Where scheme funding falls below these triggers the Pensions Regulator has a number of powers for intervening.</p> <p>As noted in our response to question 12, under-funding does not affect members' benefits; benefits are always paid out in full while a scheme sponsor remains solvent. Further under-funding should not necessarily affect a sponsor's right to continue to offer future accrual, as all benefits accrued are backed by the sponsor. (This is in contrast to insurance companies which are required to stop writing new business if funding falls below a Minimum Capital Requirement.)</p>	
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91.	No. We do not believe that additional information, to be disclosed to DB scheme members, is required.	
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