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<tr><td colspan="2">Comments Template on EIOPA-CP-11/006
Response to Call for Advice on the review of Directive 2003/41/EC: second consultation</td><td>Deadline
02.01.2012
18:00 CET</td></tr>
<tr><td>Company name:</td><td colspan="2">CONFEDERATION OF BRITISH INDUSTRY (CBI)</td></tr>
<tr><td>Disclosure of comments:</td><td>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.</td><td>Public</td></tr>
<tr><td></td><td colspan="2">The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006).

Please follow the instructions for filling in the template:
⇨ Do not change the numbering in column “Question”.
⇨ Please fill in your comment in the relevant row. If you have no comment on a question, keep the row empty.
⇨ 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.
○ 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.
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).</td></tr>
<tr><td>Question</td><td colspan="2">Comment</td></tr>
<tr><td>General comment</td><td>Higher solvency requirements are unnecessary and will slow down the recovery and destabilise</td><td></td></tr>
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	capital markets The CBI welcomes this opportunity to respond to EIOPA's final consultation on the Call for Advice (CfA) on the review of the Directive 2003/41/EC. The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. While whether or not a Solvency II-style regime should apply to IORPs is not part of the scope of this consultation, CBI members feel it is important to stress our serious concerns, and strong opposition, to this review altogether, particularly in the context of the ongoing economic crisis in Europe and the grave events happening in the Eurozone. While much of the technical detail, even in this consultation document, remains unclear, the imposition of a Solvency II-type regime for pensions, in any shape or form, CBI members believe to be unnecessary and would have disastrous economic implications for the EU and the global economy. The CBI fully supports EIOPA's call for a detailed and rigorous economic impact assessment to be carried out before the Commission makes it final decision on whether to go ahead with plans to review the 2003 Directive. Applying a Solvency II-type regime to UK DB schemes, for example, would increase existing technical provision levels by up to 85%-90%. This represents up to an additional €500bn (over 15% of the market capitalisation of FTSE350 companies)[1]. DB schemes by the nature of their activity have very long-term liabilities and matching investment strategies. This means that, unlike other financial services products, the financial stability is not affected by short-term economic turbulence and therefore this type of capital buffers are unnecessary. Instead, at a time when sources of credit remain scarce and companies' cashflow have not yet recovered from the financial crisis, forcing companies to divert money away from business investment could do serious damage to the pace of economic recovery in Europe.	

[1] 'Solvency funding in pension schemes: the application of solvency regimes to European pensions', Punter Southall Actuaries (2007)

	Moreover, increasing funding requirements for pensions would have a serious impact on investment flows in financial markets. Currently, European pension funds hold total assets worth €2,500bn. If they were to comply with Solvency II requirements they would have to hold extra assets worth €1,000bn this would mean they would have to sell equities at about the same value. This would further starve the European private sector of sources of financing, preventing them from growing their business and creating jobs. In the specific case of the UK, pension funds own around 20% of assets in the UK equity market and 25% of assets are in overseas equities, including the EU. Therefore, the cost of the sale of these assets would destabilise both the EU and international financial markets at a time when the stability of the economy and markets remains extremely fragile.	
1.	**The CBI believes that the scope of the Directive should in principle not be extended, unless new funding standards – which we oppose – create a distortion in the internal market** The European IORP landscape is a very complex one. IORPs are wholesale products that by the nature of their activity are deeply integrated into national social protection systems and therefore regulated by national social and labour laws. This means that the degree of homogeneity found in the financial services industry across Member States is lacking in IORPs due to their adaptation to specific national necessities according to the social nature of their role. While the CBI agrees with the need to ensure that all forms of pension provision are properly regulated, we do not believe a one-size-fits-all approach under the IORP Directive can be the right way forward given this diversity. Across the EU, the general objective of all Member States' regulatory provisions is the safeguarding of pension beneficiaries' claims at reasonable cost. How this is achieved, however, differs widely across national regimes. Indeed, national social and labour law may determine the content of the pension promise, set minimum governance requirements, determine the level of sponsor commitment and provide insolvency protection. This is the right approach, as Member States should be given sufficient flexibility to put in place appropriate retirement systems that are reactive to the socio-economic circumstances, needs and desires of their citizenry as well as the employers that fund those	

	schemes. Under the current regime, different European legislation governs different forms of provision based on the financial characteristics of the product. In those cases where a particular model is not covered – as can be the case in some newer Member States – social security legislation, both at EU and national level, fills in some of the supervisory gap. Furthermore, as illustrated in section 4 of EIOPA's draft response – dealing with the interaction between prudential regulation and social and labour law – any attempt to provide legal clarity on the interaction between the Directive and Member States' social and labour legislation could easily be a straight violation of the subsidiarity principle. In some new Member States the extension of the scope of the Directive would directly limit those Member States' competences on social and labour legislation. Thus, any attempt at extending the scope of the Directive to try and create a 'level playing field' in retirement provision would not only be extremely complex but would also create legal uncertainty through conflicting pieces of European and national legislation increasing costs for governments, employers and scheme members. For all these reasons, CBI members believe that the existing scope of the 2003 Directive should not be extended. However, this policy position is based on our overall opposition to the introduction of a Solvency II-style regime for IORPs. If despite the overwhelming legal, regulatory and economic arguments against such regime, the European Commission chooses to propose higher solvency requirements on funded schemes with an employer covenant, then a review of the scope of the Directive then be necessary to ensure a level playing field is restored for all providers of defined benefit schemes.	
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	The lack of consensus around the definition of cross-border activity means no changes should be made at this stage The proposal included in the draft response does not achieve consensus across Member States. The proposal to amend the definition of 'host' member state to reflect the position in respect of location of the sponsoring undertaking does not address all of the outstanding issues currently faced by employers looking to set up these schemes. This new definition would not take into account, for example, the location of scheme members and beneficiaries. This means that while the IORP could be subject to the prudential law of the 'home' member state, the sponsoring employer would be subject to social and labour law in the 'host' member state. This would lead to different regulatory regimes impacting the sponsoring employer, which ultimately funds the scheme, significantly increasing bureaucratic and financial costs. Ultimately, the key obstacle to a broad consensus in the definition of cross-border activity is the heterogeneity of IORPs because of their fundamental social role at national level. As the draft response clearly states, there is no possibility of further promoting the single market on pensions without undermining the subsidiarity principle on social and labour law, a move which is unacceptable. This is why the CBI believes little more can be achieved beyond the current text of the IORP Directive. We would encourage EIOPA to abandon its proposal for a review of the definition.	
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10.	**The subsidiarity principle must apply to pensions regulation** When considering the question of pensions regulation, CBI members believe it is the primary responsibility of member states to regulate retirement saving in a way that works best for their citizens.	

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	Pension arrangements differ substantially from one member state to another because of historical and social developments – most notably in the design of the first pilar, and the different structures of second and third pillar that have developed because of it. This diversity of provision – built on fundamentally different, but equally valid, approaches to state pension systems – means that we should avoid creating a 'one-size-fits-all' approach to pensions at EU level. The differing weight each pillar – state, workplace and individual provision – has in each member state must also be taken into account.	
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12.	**The CBI does not support a framework that includes a tiering of assets** CBI members believe that it is seriously misguided to introduce a tiering of assets, as included in the Solvency II Directive, in the superivision of IORPs. The long-term nature of pension liabilities means that the liquidity of assets to be held by the scheme is not as relevant as in the case of insurers. This is because while some liquidity will be necessary to discharge some immediate liabilities in relation to pensions in payment, long-term illiquid assets that provide higher or more secured returns are effective hedging vehicles against risks such as inflation or longevity. Moreover, institutional investors such as European IORPs, which hold over €2,500bn in assets, are also key long-term investors in the EU economy. Unlike other investors more focused in short-term returns, IORPs are able to support long-term investments, such as infrastructure, that are not liquid immediately despite the need for higher capital financing in the early years. IORPs are therefore ideal vehicles to invest into the long-term development of the EU economy as well as helping reduce the volatility financial markets have experienced in recent years. These are outcomes we should encourage, not undermine.	
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14.	**CBI members agree with EIOPA that a transfer value model is not appropriate for the supervision of IORPs**	

	CBI members do not agree that a Solvency II-style funding regime is appropriate or necessary for pension funds. This means that we do not agree with the proposal to apply a 'transfer value' model for valualing liabilities, similar to that used for insurance companies, to IORPs. The consultation document clearly outlines the negative implications of this. In particular, the long-term nature of IORPs means that they share risks across generations. Therefore, having sufficient financial assets at all times to transfer their liabilities, is not necessary. Due to their long-term nature, IORPs have the possibility to use future contributions as assets or to reduce future benefits to lower liabilities. In addition, the meaning of 'transfer value' differs across Member States. Therefore, using the principle of transfer value to value liabilities would be overly complex.	
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21.	**CBI members are strongly opposed to the use of a risk-free discount rate for the valuation of liabilities** CBI members do not believe a risk-free discount rate is always appropriate for the valuation of pension liabilities for funding purposes. For accounting purposes it is never so. Instead, we support the retention of the current methodology in the IORP Directive, namely for the scheme actuary to determine the appropriate discount rate on a prudent basis.	

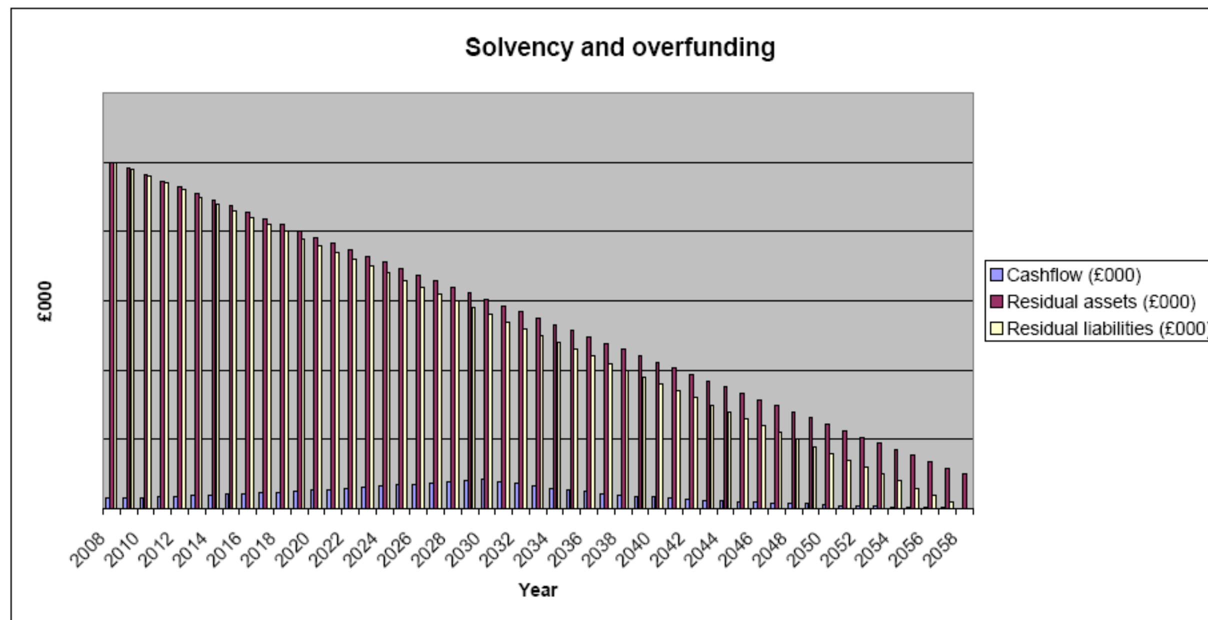
In its draft response, EIOPA does not suggest what would be the correct risk-free rate to use but any choice of a risk-free rate would still involve subjectivity in choosing the rate to use, for example whether to use government gilts or swaps and also how to extrapolate the long end of the yield curve to fit the longer term liabilities. As the current tumult in the Eurozone clearly shows, even government bonds carry some risk. Even if that situation was to resolve positively, a large-scale move into gilts by pension funds would still arguably be unsustainable and lead to poorer returns, rendering previously "risk-free" assumptions as overstatements.

A move to a risk-free discount rate will therefore not only put the economic viability of European companies in serious jeopardy, but it would also further foster the "illusion of certainty" among scheme trustees and members.

Moving to a rate based on swaps or gilts is no more conceptually sound than using a prudent rate set up by an independent actuary on the basis of the investment strategy of the scheme. We set out below further reasons why we disagree with the proposals for a risk-free rate.

Firstly, the pension scheme is an ongoing commitment for the sponsoring company. There is therefore little rationale for using a discount rate that values the liabilities at more than the cost of a total scheme buyout. Competitiveness within the pensions buyout market recently has driven a sizable reduction in price. Using with a risk-free rate of return, would massively overstate scheme liabilities and that the adoption of such rate would mean companies would no longer face the prospect of having to pay a premium to crystallise the cost of meeting all their scheme obligations. Given that insurance companies are offering to buyout liabilities for less than EIOPA's proposal would place on the balance sheet, there is clearly conceptual weakness to the proposals.

And secondly, more and more schemes are adopting liability driven investment strategies where the assets are invested to match the liabilities. Under the proposals if a scheme had perfectly matched assets the accounting valuation would still show a deficit due to the use of a risk-free rate to value the liabilities. This would lead to higher deficit repayments from the employer which would overtime lead to overfunding, as

	shown in the graph below. Whilst the current approach does not remedy this completely it goes some way to dealing with it due to the use of a discount rate that better matches a scheme's investment reality. Solvency funding in pensions - overfunding 	
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33.	**The CBI does not support valuing the sponsoring employer support as an asset** The sponsor support, or employer covenant, is at the core of DB schemes in some Member States. This is why CBI members cannot support a methodology that does not put employer support at the core of the regulatory system. A DB scheme is set up by an employer that wishes to offer its employees an efficient way to achieve a good income in retirement. The intrinsic nature of DB scheme design is that it is more efficient for members than provision through financial markets. This arises in part because the pension scheme has recourse to the sponsor's production which in return is able to direct cash towards investment in strengthening its covenant, by growing the business, instead of locking it away unproductively in the pension scheme. But also becasue of the long-term nature of pension liabilities that allow less liquidity to be readily available. In that context, the benefit to the employer of offering explicit, and in many jurisdictions legally-binding, financial support to the scheme is that it does not need to offer that support upfront. In the case of the UK when a scheme goes into deficit, the Pensions Regulator's funding regime provides trustees with the necessary powers to force the employer to provide additional funding to repair it. This is right as it	

	encourages balanced thinking. Ultimately, the best form of protection to member benefits is a strong, solvent employer. This is why employer covenant monitoring is a crucial part of the UK's regulatory system. Trustees have the duty to monitor the continuously covenant and are empowered to act when the strength of the covenant varies to ensure the solvency of the pension scheme. Furthermore, the Pension Protection Fund, funded by employers, is a mechanism of last resort to protect some member benefits in the eventuality of the scheme' sponsoring employer going insolvent. The flexibility and security offered by this approach means that CBI members does not support measuring the employer covenant as an asset. In fact, we believe such approach is riskier than the current UK model, as providing the value of the covenant at one point in time is heavily dependent on external economic and financial factors, while a permanent monitoring of that same covenant by trustees allows for a more holistic picture being considered by the scheme trustees. Therefore, we do not believe EIOPA's proposal is better than a system that encourages dialogue between trustees and the employer to ensure not only appropriate funding for the scheme, but also that the employer remains financially viable. During the worst economic crisis since World War II, this regime has shown that it can protect member benefits while avoiding mass insolvencies. Equally, EIOPA has not provided any detail on how such measurement would be done. CBI members believe measuring the employer covenant accurately enough to monetise it would not only be extremely complicated, if possible at all, but also very expensive.	
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41.	**CBI members do not support measuring pension protection systems as assets** As in the case of the employer covenant, CBI members are strongly opposed to measuring the value of pension protection systems, such as the Pension Protection Fund (PPF) in the UK, as an asset. In the case of the PPF, the Fund is a safety net of last resort for all private secor funded IORPs in the UK. The PPF protects 100% of pensions in payment and 90% of any future pension promise made to a scheme member in the event of the sponsoring employer going insolvent. The Fund is financed through individual levies paid by eligible employers every year. The high level of security provided to scheme members means that ultimately the PPF is a nearly full guarantee of any pension promise, therefore valuing it as an asset would only makes sense if it would cover the entire funding requirements of the IORP, if not it would always be undervalued. Equally, the cost of measuring the strength of the PPF would be quite significant and this would have to be covered by participating employers further increasing their costs.	
42.	**Employer affordability and flexibility are crucial to high-quality DC** Given the growing trend towards provision of defined contribution (DC) schemes, it is important to avoid introducing rules at EU level which significantly increase the costs of operating such shemes. For example, EU rules detailing how schemes should be designed. If such schemes become too costly, it is likely to lead to employers lowering their contributions or being unable to offer such schemes. Equally, in many cases in DC, for example in the case of group personal pensions (GPPs), employees are the ones that pay the administration charge for the scheme, therefore an increase in costs would directly affect them. CBI members believe that improving employee engagement is crucial to achieving good member outcomes, rather than changing the structure of schemes.	

It is right that EIOPA should look at ensuring that employers and scheme governance structures, whether through a trust or a provider, do carry out their duties appropriately. But to completely exonerate the individual saver from any responsibility in ensuring his or her pension delivers a good income in retirement is seriously misguided.

We are fully aware of the difficulty of increasing employee engagement with pensions. But that difficulty cannot be an excuse to lay all of the responsibility of ensuring good member outcomes on employers and scheme providers. CBI surveys show that employers are fully committed to helping their employees achieving a better income in retirement. In the UK, the average employer contribution in DC is almost ten per cent, while the average employee contribution is just five per cent[2]. Even during the worst period of the last recession, from 2007 to 2009, 15 per cent of employers increased their contributions to DC schemes. To solve low take-up and contribution rates, employers have also put measures in place to increase employee engagement. For example, almost half of employers communicate with employees regarding the benefits of joining the company's pension scheme and/or offer generic or individual financial advice regarding retirement saving.

DC at its best is a partnership. Employers provide financial and administrative support, while employees recognise their responsibility to plan for retirement and make their own contributions. Promoting understanding of DC schemes among employees must be a part of the better member outcomes equation. A 2008 CBI report[3] put forward seven key lessons on how to create that partnership. These were based in the experience of employers providing high-quality DC:

1. Scheme design must meet the needs of employer and employee. Employers must be clear about the objectives for pensions and how it fits the firm's people strategy.

2. Employees who feel involved, who are informed and consulted about their scheme and its design will

[2] CBI/Towers Watson Pensions Survey 2011
[3] Saving for tomorrow: the role of defined contribution schemes, CBI, 2008

	value their employer's commitment more highly. 3. High quality communication through appropriate media is vital to ensuring employees understand the benefits of the scheme and the choices they have to make. 4. Raising general financial awareness ensures informed decision-making, helping employees understand how to get the best out of their DC plan. Employers understand that employee needs vary over a lifetime – from first employment, through mid-career to the point of retirement. 5. Overcoming employee inertia is essential as too many employees do not take advantage of the benefits on offer – innovative joining techniques can be explored to boost take-up. 6. Good governance benefits employers and employees – ensuring employees get a good deal, feel involved and value the scheme. 7. Individual choices should be supported. DC puts power into the hands of scheme members – often including investment choice. Scheme design should reflect this, with well-chosen default funds and a simple approach for members choosing to manage their own portfolios.	
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44.	**CBI members are strongly opposed to prescription on the length of recovery periods at European level** The long-term nature of pension liabilities in IORPs calls for a different approach regarding recovery	

	periods to that included in Solvency II. This means that deficits are not as relevant as they can be recuperated over time. Therefore, the proposal that the scheme must carry out full valuations every year and a put in place significantly shorter recovery plans to the currently available ones is not appropriate. For example, currently in the UK the average recovery plan has a length of nine years, substantially shortening that would put companies' cashflow under significant pressure and would inevitably lead to mass insolvencies in many EU Member States, much higher unemployment and lower growth The recent recession is a clear illustration of the benefits of having a more flexible approach to recovery periods. Despite the significant impact on company cashflow and the drying out of credit lines, mass insolvencies were avoided by national regulators allowing longer recovery plan periods, protecting affordability and ensuring the solvency of scheme sponsoring employers. CBI members support the retention on the current system in which scheme trustees and the employer agree the length of the recovery plan by looking at the overall financial position of both the scheme and the sponsoring employers. Ultimately, the best form of security for a pension scheme is a solvent employer, significantly shortening recovery plans would only put that security at risk unnecessarily.	
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52.	**A Solvency II-style funding regime for IORPs is intrinsically pro-cyclical**	

	CBI members strongly agrees with the aim of avoiding pro-cyclical behaviour in the supervision of IORPs. This is one reason why we are strongly opposed to the application of a Solvency II-style funding regime for pensions. The long –term nature of pension liabilities mean that IORPs are able to focus in long-term investment returns rather than short-term liquidity. Because of the long-term nature of their activity they are less vulnerable to short-term market volatility and therefore can act as stabilisers in financial markets. The regime being proposed by the European Commission does away with the long-term investor nature of IORPs by forcing them to focus on short-term liquidity despite this being unnecessary to cover their liabilities.	
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63.	**Transparency and good governance are key to achieving better and safer pensions** CBI members believe that there is room for improvement on the area of governance in pensions and we would support action in this area. While some Member States have high levels of good governance we support the development of good practice across the EU to ensure that all Member States provide scheme	

members with clarity on governance standards.

Having said that, it is important that any review of governance requirements in the IORP Directive is pitched carefully to ensure it fits the requirements of the sector. For example, under the 'fit and proper' requirements of the Solvency II Directive the IORP is required to ensure that persons who effectively run the scheme are fit to do so, including with regards to professional qualifications, knowledge and experience[4]. This would mean that for many IORPs it would be very difficult to appoint member-nominated trustees (MNTs) who often lack relevant qualifications and skills at the time of application. MNTs are a fundamental part of the check and balances model in pension governance, providing members' with an elected representative in the scheme's governance structure. Training and skills development is offered to them by the employer after their appointment, rather than before.

Crucially, CBI members' support for a revision of governance requirements in the IORP Directive is entirely dependent on ensuring that any changes are proportional. The recent trend away from defined benefit (DB) schemes towards defined contribution (DC) schemes has been due to the significant increase in costs for sponsoring employers over recent decades. This increase has been driven by demographic changes, but also by an increase in the regulatory burden both at EU and national levels. Employers have been badly burnt by misregulation of pensions. A badly thought through review of governance requirements in the IORP Directive could easily lead to a decrease in the provision of pensions across Europe, hurting employees most. In the UK, for example, from October 2012 all employers will be required to automatically enrol their employees into a pension scheme. Pension providers should be able to offer affordable schemes to all employers, including SMEs. Over-prescriptive European rules on how schemes should be designed and run will simply increase costs significantly leading to a levelling down of employer contributions, from higher levels to the statutory minimum, or the inability of employers to afford them altogether.

In DB schemes, member engagement benefits from the schemes' decision-making structure which

[4] Article 42, Directive 2009/138/EC

	incorporates trustees with a fiduciary duty. Trustees have a fiduciary duty to act in members' interests, protecting their accrued benefit through prudent management of the funds' reserves and meaningful negotiation with the sponsoring employer. DC schemes are, on the other hand, an entirely different proposition. This is because all of the investment risk lies solely with the member. CBI members believe that good DC provision must be built on the principles of transparency, good governance and flexibility. Transparency, allows individual savers to engage and make informed decisions about their pension. Good governance promotes that necessary transparency as well as ensuring internal controls and appropriate decisions are being made in members' interests. And crucially, flexibility ensures that individual scheme design is tailored to the needs of scheme members encouraging engagement. DC at its best is a partnership. Employers provide financial and administrative support, while employees recognise their responsibility to plan for retirement and make their own contributions. CBI members urge EIOPA to bear all of this in mind when putting forward their advice to the Commission on governance. We would be very concerned about any proposal that goes too far down the regulatory approach. By pushing for over-prescription in DC governance, the Commission and EIOPA risk stifling innovation and the ability of employers to adapt their schemes to the needs of their workforce.	
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65.	**See answer to question 63 above.**	
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95.	**See answer to question 63 above.**	
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