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:	German Institute of Pension Actuaries (IVS - Institut der Versicherungsmathematischen Sachverständigen für Altersversorgung e.V.)	
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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.
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12.	We believe that the distinction between the different types of IORPs should be retained. More important, however, we challenge the central assumption taken by both the Commission and EIOPA in the development of the Pensions Directive, namely that insurance and pensions business is so similar, that the same principles - here the "holistic balance sheet" - can be used as a starting point. We do not think that this assumption is appropriate and explain our reasons below. We assume that the similarities are so well understood that the differences are less so and therefore highlight these and some consequences thereof: **A. General Comments to IORPs** 1. **The business model:** The vast majority of insurers (and effectively all of the major players) is profit-oriented and operate in a competitive market. Neither applies to pension funds, whether company-own or restricted to a profession or a pre-specified set of beneficiaries (e.g. members of a profession) alone. Pension funds in this sense do not include those that compete directly with insurers in the pensions market. We believe that this aspect alone justifies that a fundamentally different approach between the two types of entities is more appropriate.	

	2. **Ownership structure:** The vast majority of insurers (and effectively all of the major players) is oriented towards the capital markets, i.e. the shares in the entity are effectively held-for-sale by its owners. In contrast, a pension fund is held by a single owner (or its beneficiaries if a mutual structure) and is essentially held-to-maturity, since the entity as such is not publicly traded. It follows that, for measurement purposes, a mark-to-market or fair value approach makes sense for the valuation of an insurer's assets/liabilities. In contrast, for measurement purposes, a fulfilment value or held-to-maturity approach makes more sense for the measurement of pension funds' assets/liabilities. The fact that the owners of those corporate entities holding interests in a pensions fund are also effectively held-for-sale does not necessarily permit the conclusion that this requires treatment similar to insurers: the business model, the legal framework, diversity and risk profiles typically differ from those of insurers. 3. **Legal framework:** This aspect is dealt with partly in 2.6.5. We believe, however, that not all repercussions have been thoroughly considered. Insurance contracts are contracted in a free and open market (i.e. the consumer has a choice) and are therefore subject to contract/civil law because beneficiaries are contract holders. In contrast, in most countries, pension promises are subject to labour law, which can differ significantly from contract law; the consumer is thus generally not operating in a free and open market. In Germany, for example, the underlying contract is generally agreed upon (and amended) by collective bargaining agreements. The individual employee does not give his consent nor can he disagree, even if his rights are reduced. The pension promise can be weaker / softer and more malleable in the context of a pension fund (for example, in Germany, pension agreements can be and are changed by agreements with employee representatives, not every employee individually - often with legal effect for accrued benefits too). Actuarial valuation principles of liabilities and security requirements for pension funds must thus reflect the prevailing labour and social law and take account of this flexibly over time since labour and social law are not static. In short, insurers generally grant "hard" guarantees while pension funds grant "softer" guarantees. In some member states (e.g. Germany, The Netherlands), most pension funds do not necessarily guarantee benefits at all, since the fund has the right to reduce the benefits in accordance with the assets available – i.e. "soft" benefit ambitions rather than "hard" guarantees. In Germany, for	

example, in the vast majority of situations the law requires an employer to underwrite any shortfall not met by the fund.

This framework is clearly more flexible than that typically applying to life insurers. This flexibility is often justified, to varying degrees, by the existence of an employer covenant. In some jurisdictions there is a further safeguard: should the employer too be unable to fulfil the pension promise given, the promise can be protected by an insolvency protection institution for occupational pensions.

Within the context of the holistic balance sheet we understand that EIOPA and the Commission interpret the value of the employer covenant and the insolvency protection as not being assets that can be directly held against the technical provisions but rather only against the SCR and the Risk Buffer. We believe that this approach is not appropriate when viewed in the context of a pension fund's characteristics.

4**. Diversity:** This aspect is partly dealt with in 2.6.7. However, we believe that here too, not all repercussions have been considered thoroughly. There are about 5,000 insurers and about 140,000 pension funds in Europe. As EIOPA quite correctly states, the aspect of relative cost of satisfying any regulatory requirements is thus of much greater significance for pension funds. However, EIOPA does not mention that the types of products offered by pension funds (i.e. pension promises) are far more diverse in nature than insurance products. The combination of this numbers / diversity issue must have a significant repercussion on regulation, since otherwise, diversity will be intentionally extinguished. The result will very likely be that all risk will be shifted onto beneficiaries. This aspect falls firmly into the area of social policy and should not be brushed aside by the Commission as "not our responsibility".

5**. Risk profiles:** Typically, insurance contracts exclude a large number of specific risks (e.g. unhealthy lives), whereas pension funds are more inclusive (because normally all employees are to be covered).

6**. Is the holistic balance sheet really holistic?** If the Commission argues that 3rd pillar regulation (i. e. that of insurers) should be imposed on the 2nd pillar (i.e. that of pension funds) it would seem illogical not to extend this approach to the 1st pillar (i.e. that of social security) too. There seems to be no reason to limit the proposals only to the 2nd and 3rd pillars. We believe that the three pillars of pension provision are a well established blend of distinctly different approaches that make the entire system of retirement provision more resilient (and holistic!) than narrowing down the alternatives to two or even one approach.

B. Specific Recommendations

Even though we believe it to be inappropriate in principle, if the proposed holistic balance sheet approach is to be followed regardless, it should take the following points into account:

1. We believe that the key quantitative parameters of the Solvency II model, namely the mark-to-market and mark-to-model valuation requirements for plan assets and liabilities, respectively, the one-year forecast period at a statistical confidence level of 99.5% cannot be copied unchanged to pension funds. The main reasons for this assessment include:
    - As compared with insurers, pension funds typically operate according to a different business model, typically have different ownership structures, are subject to a very different legal framework, currently encapsulate more diversity and have different risk profiles;
    - Excessively high and volatile capital requirements based exclusively on the state of financial markets (duration gap between available assets and liabilities; low interest rates; state of the markets at the valuation date) are inappropriate for pension funds.

2. The enhanced security provided by the employer covenant and by insolvency protection institutions should, in principle, be taken into account in the same way as financial assets.

3. The softness of a pension fund's obligation must be taken into account when assessing the discount rate for discounting future pension obligations. An approach for determining the discount rate comparable with that required under international accounting standards, i.e. using yield curves that reflect AA-credit rating, would be more suitable and appropriate than a risk-free interest rate. We also believe that the instruments currently being discussed in the life insurance industry (construction of synthetic yield curves applying illiquidity premiums, countercyclical premiums, etc.) are unsuitable for pension funds.

4. In our view the valuation of technical provisions with a view to transfer values is inappropriate. The main reason is that pension funds are effectively not held-for-sale.

5. Recent experience has shown that mark-to-market approaches have their significant weaknesses. When markets are subjected to severe stress (quantitative easing; downgrading of sovereigns; general loss of trust), politically motivated measures are deemed necessary and implemented, e.g. by the construction of synthetic yield curves allowing for illiquidity, counter-cyclicality, theoretical forward rates, etc. In other words, mark-to-market approaches have shown that they are neither resilient nor durable in the face of stressed markets.

   We believe that the mark-to-market approach, the annual projection horizon coupled with the 99.5% confidence level as applied under Solvency II is unsuitable for IORPs because the resulting high volatility of balance sheet amounts result in high swings in capital requirements that are generally unjustified.

6. In summary we consider that

   a. The financial and other assets must be sufficient to cover the technical provisions;

   b. There is no need for a risk margin in addition to the technical provisions as deviations from the technical provisions are already included in the SCR;

   c. A sufficiently clear and simple assessment of the value of the employer's covenant and the value of the insolvency protection must be ensured;

   d. A very significant simplification and easing must be permitted in accordance with the principle of proportionality. For instance, smaller funds should be permitted to prepare its balance sheet in simplified form (or excluded altogether) and only in intervals of several years;

   e. The transition period for implementation must be suitably long to allow time for adjustment

13.	We disagree. We believe that a mark-to-market valuation of assets is not suitable for risk-managed IORPs. Strong volatility in asset values would lead to amplified volatility in capital requirements. These fluctuations would in turn be contrary to the nature of an IORP: its long-term obligations, held-to-maturity financial assets (and the resulting loss-absorption possibility) as well as the typical lack of a sponsor's and members' cancellation options. Furthermore, we see the danger that a fair value approach would force IORPs towards pro-cyclical investment decisions. This would enforce the trend to overinvest in overvalued securities.	
14.	Only under exceptional circumstances do German IORPs have the option to transfer contracts to a third party. In contrast to life insurers and in line with an IORP's business model, a market value of their liabilities does not exist. EIOPA's proposal is thus an artificial construction. The central premise of selling both assets and liabilities bears no link to reality and is inappropriate in the context of an IORP's business model. Hence, there cannot be a requirement for additional risk capital due to a mark-to-market valuation.	
15.	Since the business model of an IORP is such that its credit worthiness is not even theoretically appropriate, we agree with this assessment. In particular, the model is not suitable for German IORPs because the liabilities originate from the employer and are protected by legally installed insolvency measures. They are not dependent on an IORP's credit standing. Hence, an IORP's arithmetically determined credit standing does not increase the risk of default for the beneficiary. For this reason, the concept of taking the IORP's credit standing into account when valuing liabilities is not at all appropriate	
16.	Compatibility between accounting standards and supervisory valuation standards is essential.	

	However, reference here is to local and not international accounting standards. In Germany, local accounting standards are the foundation for the management of an IORP, e.g. with regard to the amount and timing of surplus distribution and should therefore remain the basis for capital requirements. Deviations from local accounting requirements will lead to internal contradictions. Any changes to the existing process must be accompanied with suitable transition periods that take into account residual maturities of existing liabilities. IORPs typically do not have sufficient means to easily adjust to changes and could actually cause their windup.	
17.	A market valuation is inappropriate for German IORPs; see answers to questions 12-14.	
18.	Since a risk margin is supposed to represent a “surcharge” for any potential buyer of an IORP it should not be included in the calculation of the technical provisions. Since the transfer of pension contracts is only possible in exceptional circumstances in Germany, there is no market and therefore no value for the transfer of liabilities.	
19.	We agree that the calculation of technical provisions should take account of pension rights earned on the basis of past contributions as well as pension rights arising from future contributions. However, something else could apply if, on the basis of a contractual agreement or an entitlement under labour law, future contributions can be rejected.	
20.	We agree.	
21.	As we have already mentioned, it is questionable whether a mark-to-market valuation of liabilities is the right approach to determine the capital requirement. The risk-free discount rate is determined according to Article 86. However, the method by which this risk-free rate is to be determined is still unknown. In the context of a holistic balance sheet, the preferable approach would be to use the two discount rate approach. If the IORP’s benefits are secured by the sponsor’s covenant, then to determine the minimum funding requirement, we believe that the discount rates used under IAS 19 (AA-rated	

	corporate bonds) can be applied.	
22.	If the IORP bears the administration costs for servicing the accrued pension rights, then these should also be allowed for in the technical provisions. However, this should not apply if the employer bears the administration costs.	
23.	We disagree. Article 78 of Solvency II does not consider the particularities of German occupational pensions in relation to the involvement of sponsor and beneficiaries in the running of pension plans. Beneficiaries (i.e. members) and the pension plan sponsor jointly decide on the distribution of surplus and thereby also take account of the IORP's risk position. We believe that benefits that are discretionary or conditional (e.g. on the distribution of future surplus) should only be included in the best estimate of technical provisions if a legally enforceable right to such payment exists, e.g. a minimum guarantee. In terms of Article 91, para. 2 Solvency II, we do not consider these as part of the liabilities.	
24.	We disagree. A conclusive fair value of liabilities based on balance sheet date data and derived from highly volatile capital markets is, in principle, not appropriate. The calculation of a capital requirement based on a mark-to-market valuation therefore makes no sense. This is substantiated by the fact that any form of life-long and guaranteed promise leads to unhedgable duration gaps between assets and liabilities. When valuing guarantees and options, it must be ensured that when having valued a guaranteed benefit, this is not valued a second time as a guarantee in the above sense, thereby leading to double counting. Any valuation of guaranteed benefits can only and exclusively be performed by a discounted cash flow methodology that is already taken account of in the best estimate liability. In determining the cash flow of guaranteed benefits, any additional contractual rights can be allowed for where appropriate and where not in conflict with the principle of proportionality.	
25.	We agree that it is useful to perform an appropriate segmentation when calculating technical provisions as long as it is not in conflict with the principle of proportionality.	
26.	Similar treatment of recoverables from reinsurance contracts and special purpose vehicle is useful so	

	long as they allow for the specific characteristics of IORPs (see responses above). Furthermore, defaults and timing differences in claim adjustments when insurance coverage is awarded to reinsurers or special purpose vehicles in significant volume should be allowed for. This corresponds to current risk controlling practice which continues to apply irrespectively of any translation of Solvency II for IORPs.	
27.	We agree. The quality of data has always been an important prerequisite for an actuarial valuation of an IORP's technical reserves. The use of approximations or individual case analyses should continue to be performed where considered reasonable. An escape clause would be useful. This corresponds to current methods which continue to apply irrespective of any translation of Solvency II for IORPs.	
28.	Yes. It is indeed useful to regularly compare best estimate assumptions against experience. This corresponds to current practice which continues to apply irrespective of any translation of Solvency II for IORPs.	
29.	We agree. Upon the supervisor’s request, it is sensible for an IORP to be required to demonstrate the appropriateness of the technical provisions and the valuation methods used. However, IORPs should be given greater latitude in their choice of methods when determining technical provisions. All the more so, when applying the holistic balance sheet approach, since this would require significant adjustments to appropriately take account of the particular circumstances of the fund and specific national characteristics.	
30.	We agree. The supervisor should indeed have the right to demand an increase in the technical provisions if they do not satisfy the requirements. However, as mentioned in our answer to question 12 it must be ensured that the appropriate aspects are taken into account in the calculation of the technical provisions and any employer covenants or insolvency protection schemes. The supervisor must also allow IORPs an adequate recovery period, e.g. by agreeing on a plan that allows sponsors enough time and sufficiently takes account of available sources of surplus and employer covenants.	
31.	Subject to such measures taking account of the factors set out in our response to questions 12, we agree. These include allowing appropriately for national characteristics, insolvency protection systems, mechanisms for adjusting benefits, the characteristics of benefits under labour and social	

	policy aspects. In particular, the necessary level of security mutually agreed between the social partners and the IORP at national level must be allowed for. In addition, a yield curve for determining the discount rate that adequately reflects the liability's character should be specified. In doing so, any limited rights that beneficiaries have to a surrender value can be allowed for, too.	
32.	We disagree. For the reasons stated above, the national supervisor should be given the freedom to set additional rules so that the specific characteristics of IORPs in their area of jurisdiction can be appropriately catered for.	
33.	We agree in principle. However, the employer covenant or sponsor support must be taken into account as an asset. Of particular importance is that the determination of the amount is laid down in detail and that this contingent asset may be applied without limit to cover effectively all liability positions on the balance sheet. In doing so all characteristics need to be taken into account – e.g. benefit reduction mechanisms, adjustment of future contributions, obligation of the sponsor to make good any deficit, etc.). As stipulated in 10.6.22 benefit reduction mechanisms must, alternatively, also be allowed to be recognised as lowering impact on technical provision. Since such determinations are presumably highly complex, we emphasise again that significant simplification and even total exclusions should apply in order to satisfy the principles of proportionality and a reasonable relationship between costs and benefit of this exercise. For industry or group-specific funds, complexity would increase because of the many different sponsors.	
34.	We disagree. The Articles should not be applied to IORPs. The fundamental assumption of market value justifies the non-applicability for IORPs. Since all subsequent provisions effectively build on this foundation, the entire system is not appropriate for IORPs – for reasons please see our response to question 12.	
35.	We agree. It goes without saying that subordinated loans from sponsors should be permitted, preferably to a greater extent than is currently the case in Germany.	
36.	As described in our response to question 12, we believe that uniform valuation principles for all member states are not appropriate due to heterogeneous labour and social laws, differences in	

	insolvency protection systems and in particular due to the requirements for setting such a probability. Even within a single member state, the social partners and the IORP can agree to different security levels even if there is generally a link between the agreed benefit and security levels. Finally, there is no need for such uniformity because they do not compete with each other on a cross-border basis nor is cross-border activity of practical relevance.	
37.	We disagree. Since essentially all benefit systems in Germany typically exclude the possibility of surrender or lump sum payments, a one-year time horizon is not necessary. In fact, it would be counterproductive since it would set the wrong incentives and emphasis for investment strategy. A long-term and sustainable investment strategy would be made very difficult if not impossible. This in turn would negatively impact the sponsor's financing costs and/or the beneficiaries' amount of benefits. Instead, there should be a reference to meeting future payments i.e. ensuring adequate liquidity should be the focus of any solvency regulation for IORPs and not the improbable danger of overindebtedness.	
38.	Appropriate consideration of characteristics and special security mechanisms for occupational pensions is worth considering, but is not particularly conducive to IORPs. This is because, even allowing for these mechanisms/characteristics (e.g. sponsor's subsidiary liability), the Solvency II approach to determine risk-based capital is not suitable for IORPs. The mark-to-market valuation of assets and liabilities is fundamentally inappropriate because capital markets can be highly volatile. This applies in the same way to the concept of a risk-based calculation of a capital requirement that is based on mark-to market principles. Any form of long-term guarantee will lead to non-hedgeable duration gaps between assets and liabilities, given the predominant annuity character of benefit delivery in Germany and the effective absence of surrender values. Any mark-to-market method to determine the capital requirement would lead to mismanagement and commercially unsound capital demands. The additional funds would have to be provided by the beneficiaries and/or the sponsor and would considerably reduce the IORP's overall efficiency. The result could very possibly be a reduction in the availability of occupational pensions. Instead of intending to achieve risk-based capital requirements, we would recommend the strengthening of and focus on a risk-oriented management of the IORP as a whole. However, this cannot be based on the allegedly required capital but should rather be based on the future business development in general, ALM studies and stress tests. Furthermore, the current distortions in the capital market clearly show how market yields can be significantly affected by political measures. To determine and hold risk-based capital when such distortions prevail leads to mismanagement and	

	increased costs.	
39.	If the SCR is to be determined on the basis of Solvency II regulations, then the assessment should be on three-yearly basis. An annual assessment would put considerable pressure on the IORP's resource infrastructure.	
40.	Considering the requirement for a MCR is understandable. However, a definition for IORPs similar to that of Solvency II is not appropriate without significant and fundamental changes to occupational pensions in Germany. Furthermore, the current IORP directive is in a sense a similar regulation, providing as it does for the holding of a guarantee fund. This approach, based on a flat rate percentage should continue as it is practical.	
41.	Since pension protection schemes considerably reduce the default risk for beneficiaries should the sponsor default, it is only right that such systems are included as a risk minimising factor within the holistic balance sheet approach.	
42.	In principle we agree that operational risk should always be considered and controlled. However, a differentiation between DC and DB plans should not be made. DB plans have an implicit operational risk and should be included here too. To allow for the different characteristics of pension schemes in member states, the valuation should not be performed on a uniform basis.	
43.	In Germany, IORPs are already currently obliged to inform the supervisor when their financial situation worsens (e.g. by having to perform stress test). The German supervisors have wide-reaching powers to impose measures to ensure that obligations are met. The rules applicable to benefit reductions require the IORP to obtain the supervisor's approval before implementation.	
44.	The length of the recovery period should be aligned with the duration of the liabilities, i.e. with a generally very long duration and should be agreed upon with the supervisor. In doing so, the effect of any surrenders and lump sum options should be considered. Hence the periods prescribed in Articles 138 and 139 of Solvency II are too rigid and in most cases,	

	too short.	
45.	We disagree. The free disposal of assets should not be automatically withdrawn if an IORP does not comply with solvency requirements. In the first instance it should be checked whether the rule relating to benefit reductions can alleviate the IORP's situation and whether the fund has set up a reasonable recovery plan. Only if these measures are not effective, should supervisors in the second instance prohibit free disposal of assets.	
46.	We agree. If an IORP cannot meet the solvency requirements, it should be required to submit to the supervisor a financial restructuring plan and agree future steps with the supervisor (this is similar to the approach already in place for certain types of vehicles in Germany).	
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	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
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