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:	Macfarlanes LLP	
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
	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).**	
Question	**Comment**	
General comment	1. Macfarlanes LLP is a firm of lawyers whose clients include companies, business investors and IORP trustee boards. Many of our clients operate in more than one EU member state, and some are non EU companies which invest in and support European businesses and jobs. We share an interest with	

	our clients in the promotion of conditions under which employers can provide pensions for their employees domestically or throughout the EU efficiently and cost effectively, and in the governance and sustainability of employer sponsored pension arrangements. We welcome this review of the IORP Directive and the opportunity to provide input. 2. EIOPA rightly points to the political nature of some of the choices which are being considered. We appreciate that these matters are not within EIOPA's remit, and not within the scope of this consultation. However, some of the proposed changes to the Directive are so far reaching that we wish to record our view that the proposed Directive is likely to inhibit rather than to promote the functioning of the single market, fails to advance the policy agenda of the original Directive and is in conflict with wider policy objectives of promoting employer-sponsored pension provision and ensuring the health and growth of European business. We believe the proposals are unnecessary for adequate member protection. Member protection is already dealt with in the current Directive and those (few) Member States which have large numbers of IORPs have significant additional protective mechanisms at national level. The amended Directive will generate substantial additional compliance costs for those businesses and schemes affected. Unnecessary changes and cost deter pension provision by employers, at a time when it is recognised that Members States and individuals may not be able to provide adequate retirement income due to changing demographics. The Directive will not provide common levels of member security under all EU employer sponsored schemes, since many such schemes remain excluded from its application. The proposals fail to recognise the reasons for the lack of growth of cross-border schemes and therefore equally fail to set out a coherent framework which would allow multinationals to organise their pension provision efficiently. In summary the amended Directive: • is likely to deter rather than promote employer-sponsored pension provision within the EU; • is likely to deter rather than promote cross-border pension arrangements within the EU; • is not necessary for adequate member protection; • is likely to damage European business and deter inward investment into the EU; • is neither appropriate, proportionate nor comprehensive in its regulation of employer-sponsored	

plans within the EU; and

- is not necessary for and will inhibit rather than facilitate the functioning of the single market.

3. Legally, the proposal to create a common regulatory framework for insurance companies (established in order to provide consumer products for profit), and pension schemes (established as a by product of an employer's business as part of employee reward arrangements), is flawed. Conventional company pension schemes do not compete with insurance companies, and attempting to regulate them in order to provide a level playing field which is unnecessary is itself anti-competitive, interferes with existing legal rights and expectations in a way which cannot be justified and which may be subject to legal challenge in a variety of ways under domestic and EC law. Material changes in legislation which unnecessarily increase costs or business at a time of particular economic difficulty will not be understood by existing and prospective investors within the EU.

4. Under UK company law, the company's objective is the prosperity of its business for the benefit of its shareholders. The principal duty of the company's directors is the promotion of that objective while having regard to a wide range of interests and stakeholders. Employees are one (but only one) of such stakeholders: defined benefit pension members have no special legal status. Their protection comes from the continued health and profitability of the employer's business, the assets separately held in the pension scheme, the insurance protection afforded by the Pension Protection Fund and the strict legal and regulatory protection already afforded under UK law. Regulation appropriate to pension schemes allows these interests to be balanced; regulation appropriate to insurance companies does not.

Because the proposals could adversely affect the company's objectives set out in its governing documents and the basis on which investors have committed funds, they amount to a retrospective change in company obligations and effectively re-write the terms on which the pension promises were made. The proposed Directive interferes with private (often long-standing) contracts, negotiated and executed under existing law, and alters members', employers' and shareholders' legitimate rights and expectations without justification.

	5. Many of the proposed changes to the Directive would cut across established UK law, with its emphasis on trustee decision making within the framework of trust law. Trustees are expected to exercise their own judgment having regard to the particular circumstances taking professional advice where appropriate rather than simply administering prescriptive requirements. There is no justification for interfering with established law when member security and other public policy objectives are already established in domestic law and regulation and existing EU law.	
1.	**(CfA 1 Scope of the IORP Directive) Do stakeholders agree with the analysis of the options (including the positive and negative impacts) as laid out in this advice? Are there any other impacts that should be considered?** We agree broadly with the analysis of the options, but the existing exclusion of book reserves from the Directive should be extended to cover defined benefit schemes. If book reserves are security for deferred pension promises by the employer, defined benefit schemes provide the same function, arguably to a higher degree, since in addition to statutory insurance assets in UK schemes of this nature are held in trust structures, which are legally separate from the employers business and which therefore ensure increased protection for members. There is no logical reason for not excluding defined benefit schemes from the Directive's application in the same way as book reserve schemes unless all other employer sponsored pension arrangements are to be brought within the Directive's ambit.	
2.	**(CfA 1 Scope of the IORP Directive) Are there any other options that should be considered? Please provide details including where possible in respect of impact.** See response to question 4. It would be useful to differentiate requirements for conventional company pension funds (whether or not IORPS) from those which are established in order to attract new customers or new transfers. The measures put forward by EIOPA appear intended to introduce a level playing field between insurance providers and competing IORPs, and legislation should be targeted only at those IORPs which do in fact compete. The vast majority of IORPs that are the subject of proposed regulation do not have any ability to market themselves or expand their	

	activities; they are open only to employees of the sponsor group rather than the wider public. What we have described as conventional company IORPs are not relevant to a single EU market. There may be some IORPs and other pension arrangements such as the UK NEST which are designed to attract new customers, and as noted above these types of arrangements could be included.	
3.	**(CfA 1 Scope of the IORP Directive) Which option is preferable?** Option 1	
4.	**(CfA 1 Scope of the IORP Directive) Are there occupational pension schemes currently falling outside the scope of the Directive, without being explicitly excluded? Are there border line cases that may need further attention**? Yes. In terms of borderline cases, there could be corporate/non-insured buy out vehicles or trust based schemes that do not strictly relate to any employer or only notionally relate to an employer. In the UK, industry-wide vehicles such as NEST and its competitors may be appropriate subjects for such regulation and may well be compared to insurance industry vehicles. See response to question 2.	
5.	**(CfA 2 Definition of cross border activity) Do stakeholders agree with the analysis of the options (including the positive and negative impacts) as laid out in this advice?** No. The background analysis and options are over complicated. Some of the options create material negative impacts for particular businesses and schemes, which are both unnecessary and unjustified. Cross-border activity has been inhibited principally because of the immediate full funding obligations included in the current Directive and because of the bureaucratic interpretation of social and labour law requirements by some Member States. The proposed amendment of Articles 6(c) and (j), as set out in paragraph 5 of EIOPA's advice would immediately convert some schemes from operating purely in the national sphere to becoming cross-	

	border schemes, with the immediate full-funding obligation that this entails. Many schemes within the EU operate with parent company guarantees. A UK scheme which has the benefit of a guarantee from its German or Italian parent, for example, would immediately be treated as a cross-border scheme, although the guarantor is not the sponsor in the accepted sense. The result could have serious financial implications for some EU groups with UK subsidiaries, without there having been any change in circumstances and where there is already proper member protection under domestic law and the current Directive. As previously discussed, this retrospective amendment of a company's obligations could be open to challenge, and is likely to be viewed with dismay by investors in European business.	
6.	**(CfA 3 Ring fencing) What is the view of stakeholders on the proposed principles of ring-fencing? Are the principles responding to the concerns expressed in the CfA?** Ring-fencing could in principle provide a possible solution to various issues e.g.: • allowing commercial pension provision (i.e. where the IORP operates in competition with an insurer) to be ring-fenced from any non-commercial activities. This would allow proportionate and targeted regulation of those activities for which regulation is justified without undue burdens being created for non-commercial activities which are not proper targets for further EU regulation. • allowing different prudential standards to be enforced for cross-border activities without a disproportionate impact on domestic pension arrangements (in those jurisdictions where Pillar 2 is already developed) albeit that we note that this should be unnecessary if the original single passport concept is respected. • allowing a distinction between new and existing commitments so that future pension provision could be built on any new prudential rules adopted without disruption to the prudential balance or value of existing commitments. If ring-fencing is used to promote the expansion of provision and mobility it may be justified.	

	However, care must be taken that ring-fencing is not used in such a way as to inhibit the development of cross-border schemes more generally. Generally, greater regulation and complexity will inhibit rather than encourage employers from adopting cross-border schemes and extending pension provision. While in many cases we believe cross border schemes can and should be operated without ring-fencing, the latter could on occasions prove useful and should not be prohibited, but available to schemes on an optional basis. We agree that there is a need for clarity for establishing situations that warrant the use of ring-fencing in stress situations. There might include arrangements that have a different origin (such as local and cross-border, insurance activities and non-insurance activities) and arrangements with different sponsors or guarantors or where a different party bears a risk (such as the distinction between defined contribution schemes with a guaranteed return and those defined contribution schemes with the benefit of a guarantee).	
7.	**(CfA 3 Ring fencing) How to stakeholders evaluate the positive and negative impacts of the introduction of the proposed principles of ring-fencing?** The proposed principles will be positive if they are used for proportionate regulation, such as if a new prudential framework were to be established for future pension provision without undue interference with existing legal rights and obligations, but not if they are used in such a way so as to discourage cross border provision entirely. The proposed principles respect the various local investment rules, benefit policies and social security arrangements in different host Member States.	
8.	**(CfA 3 Ring fencing) What is the view of stakeholders on making ring-fencing obligatory in case of cross-border activity? Should the Member State be obliged to introduce such rules or only in the cases where investment rules are not compatible?** We are not in support of making ring-fencing obligatory in the case of cross-border activity. Ring-fencing would make cross border schemes more costly and less efficient, because there would be	

	little practical difference from operating separate IORPs. The greater efficiency in the method of provision, the greater the resources available for pension provision.	
9.	**(CfA 3 Ring fencing) What is the view of stakeholders on the introduction of privilege rules? Should the Member State be obliged to introduce such rules? If not, why not? If yes, why?** Privilege rules should not be introduced. Where they already exist, these should continue to be respected by allowing ring-fencing of any IORP activities to which privilege rules apply. In our view, the introduction of privilege rules has little to do with expanding provision or with the sustainability of pension provision. This is a matter of social and labour law and so should be in the domain of the Member States.	
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12.	**(Chapter 8 – Quantitative requirements) What is the view of the stakeholders on the holistic balance sheet proposal? Do stakeholders think that the distinction between Article 17(1) IORPs, 17(3) IORPs and sponsor-backed IORPs should be retained or removed?** 1. Company pension schemes work (in a funded context) by putting assets aside with the prospect of continuing to do so, as long as the scheme continues. In a UK context, the trust assets set aside in this way are bolstered by a variety of legal obligations and protective mechanisms, designed to provide member protection while recognising the range of other obligations (e.g. to bankers, suppliers, creditors and employees). The objective of Solvency II levels of reserves in respect of company schemes is therefore inappropriate. The holistic balance sheet, which is designed to shoe-horn company pension schemes into an insurance framework is superficially attractive, but is probably unworkable as envisaged as well as being both unnecessary and harmful. 2. The application of any solvency objective of the sort proposed could not be achieved without an extremely long transition period, since the retrospective nature of the obligations sought to be imposed will have an extremely significant impact on sponsoring companies and their investors and	

	their ability to sustain current levels of pension provision. From a practical viewpoint, the changes are likely to damage those companies' ability to respond to current economic challenges and to contribute to the recovery of the European economy. They represent an unnecessary use of capital resources which could be better used elsewhere, since members are already protected under current law. 3. The holistic balance sheet itself carries a number of difficulties with it. How is the value of the employer covenant to be properly valued in any meaningful way, when normal business activity could mean that changes in the value would have to be reflected in additional contributions or security within a short time scale? What about the costs of such valuations, and the management time involved? And if additional contributions or security cannot be found to balance any cyclical downturn what is to be the result? Members do not have the choice of getting another employer to contribute to their pension – and unnecessary demands on the business could prejudice members' jobs as well as their pension. These are unnecessary diversions from the company's business and unnecessary given the degree of member protection already afforded under domestic and EU legislation. The distinction between Article 17(1) and 17(3) IORPs and sponsor based IORPs should be retained. The suggestion in paragraph 8230 of the consultation document that the existing distinction could give rise to regulatory arbitrage is wholly academic. No employer choosing to set up a company pension scheme would consider this as an issue. Additionally, defined benefit pension schemes in the UK are not in competition with one another in finding new customers.	
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16.	**(CfA 5 Valuation of assets, liabilities and technical provisions) What is the stakeholders' view on inserting a recital in the IORP Directive saying that supervisory valuation standards should, to the extent appropriate, be compatible with accounting standards?** Aligning supervisory valuation standards with accounting standards would be ill-advised. The	

	accounting standards themselves are not perfect, as seen when an increase in yields for corporate AAA bonds in the credit crunch led to accounting surpluses; the surpluses generated were phantom surpluses. Legislating so as to follow accounting standards automatically would of course amount to a transfer of legislative power to the IASB.	
17.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree with the EIOPA view to adopt Articles 76(1), (4) and (5) with appropriate amendments into a revised IORP Directive? What is the stakeholders' view on the two proposed options regarding Article 76(3)?** We do not agree that reference to prudence in the calculation of technical provisions should be removed. Company pension schemes are based on a variety of factors which are specific to the scheme and employer concerned; established trust law and regulation within the UK places the judgment of the parties as to what is prudent in their particular circumstantiates at the heart of decision making. Removing prudence as a concept influencing decision-making is unnecessary; it would be detrimental to the UK legal and regulatory system, and reduces necessary flexibility.	
18.		
19.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree with the proposed conditions defining in what cases IORPs should take into account future accruals or not when establishing technical provisions?** Funding decisions should be agreed between the scheme trustees and the employer, based on the professional judgment of the scheme actuary.	
20.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree that the best estimate of IORPs should be calculated gross without deduction of amount**	

	recoverable from reinsurance contracts and special purpose vehicles? Yes. The best estimates of IORPs should be calculated gross without a deduction. The Pension Protection Fund protects broadly 90 percent of benefits and provides compensation up to 100 percent for those members who have reached their scheme's normal pension age.	
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23.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do the stakeholders agree with the analysis regarding the inclusion of unconditional, conditional and discretionary benefits in technical provisions as introduced by Article 78 of Solvency II? Do stakeholders find that discretionary benefits should be included in the best estimate of technical provisions? Is the Solvency II article on surplus funds useful for IORPs in this respect?** No. Discretionary benefits should not be included in the calculation of technical provisions. The purpose of funding is to ensure that benefits to which members and their dependants are legally entitled can be met. By their nature, no entitlement arises to discretionary benefits. The analysis here is in danger of confusing member expectations with rights, and as such, is particularly unhelpful.	
24.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree with EIOPA's view of introducing Article 79 of Solvency II with appropriate amendments into a revised IORP Directive regarding allowances for financial guarantees and contractual options when establishing technical provisions?** No	
25.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree that it would be useful to introduce Article 80 of Solvency II with appropriate amendments into**	

	a revised IORP Directive regarding appropriate segmentation of risk groups when calculating technical provisions? No. This would not be useful and would interfere with established trust law in the UK.	
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28.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders believe that it would be useful to introduce Article 83 of Solvency II with appropriate amendments into a revised IORP Directive regarding the need for assumptions to calculate technical provisions to be regularly compared against experience and adjustments made when appropriate?** No. It would not be helpful to introduce Article 83 of Solvency II with amendments; such judgements should be left to the scheme actuary.	
29.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree that it would be useful to introduce Article 84 of Solvency II with appropriate amendments into a revised IORP Directive regarding the need for IORPs to demonstrate to the supervisor on request the appropriateness of the level of technical provisions?** No. The current system of valuations works and the law provides for prudential valuation and the involvement of the UK regulator.	
30.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree that it would be useful to introduce Article 85 of Solvency II with appropriate amendments into a revised IORP Directive regarding powers of the supervisor to require IORPs to raise the amount of technical provisions corresponding to supervisory law?**	

	No. As already noted, with long-term but generally predictable commitments, company pension schemes should be regulated in a way which allows a balance to be struck between affordability to the company and the rights and interests of members and stakeholders. Current UK law does that. It would be inappropriate to alter scheme specific funding as applicable under UK law to be retrospectively replaced by an unnecessary prescriptive standard. As already explained, the judgement of trustee boards and employers, policed by regulation in the event of disagreement, works.	
31.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree that a new IORP Directive should allow for the Commission to adopt level 2 implementing measures regarding the calculation of technical provisions as introduced by Article 86 of Solvency II?** No. This would be inappropriate given the potential impact that potential changes could have on business. This should not be done other than at the highest level.	
32.	**(CfA 5 Valuation of assets, liabilities and technical provisions) Do stakeholders agree that individual Member States should not be permitted to set additional rules in relation to the calculation of technical provisions as currently allowed under Article 15(5) of the IORP Directive?** Individual Member States should not be able to make the calculation of technical provisions more difficult. The current Directive provides an appropriate framework.	
33.		
34.	**CfA 6 Security mechanisms**	

Preliminary comments on security mechanisms

It is important to recognise that security mechanisms, including those addressed in EIOPA's consultation document, are not cost-free and are likely to represent a transfer of value or a redefinition of the "social contract" between stakeholders (to use the terms of the consultation (see 10.6.8) or indeed of the explicit legal obligations of the parties (including both employer sponsors and guarantors).

Legislative changes intended to apply in relation to existing obligations which are already binding on the parties effectively represent a retrospective variation of the financial obligations assumed by the parties. Accordingly, there must be strong justification for such intervention if it is to apply to existing obligations, or a specific carve-out to ensure it applies only to obligations that may be assumed by private parties in the future.

The stated objectives for revising the IORP directive include member protection, increasing pension provision across the EU and creating a level playing field between IORPs and insurance companies. Each provision should be justified by reference to these objectives. Unfortunately, many of the suggested changes to the Directive will not promote the various objectives which the Commission has in mind.

For various reasons, in part relating to the definition of the role of EIOPA, the scope of the Directive excludes certain types of pension provision, including book reserve schemes and pension schemes which are not established by the employer or where the employer does not play an essential role in the funding of the scheme. The consequence is that the proposals will apply to pension schemes that are not in any significant sense in competition with insurance companies and so will not ensure uniform levels of member protection within EU pension arrangements (for instance the UK National Employment Savings Trust (NEST)), but will significantly damage pension schemes which are not in competition with them, without any material increase in member protection.

This is relevant to the "level playing field" argument for applying Solvency II in a modified form. In the UK, IORPs established by employers are non-trading, cannot themselves decide to expand their activities by entering new markets or admitting new members (or customers), cannot generally terminate their activities (in the sense of 10.3.32 i.e. the inclusion of new rights for participants) and do not provide a profit to shareholders. In the sense of 10.3.204, these IORPs do not (and, under the terms of their constitutional documents, generally cannot) "act in a manner similar to insurance companies". Many IORPs are in fact customers of insurance companies rather than their competitors. While it may be appropriate to legislate, by reference to the need for fair competition, for those that do or can compete with insurance companies, such as NEST, it is not appropriate to impose these requirements on those who are not competing. A 'level playing field' is not required for non-trading IORPs, because they are not 'players' and are not 'in the field'. The rules intended to support the single market in financial services should only apply to those who are or could be market participants. Furthermore, the application of rules to level a non-existent playing field in a way which places disproportionate burdens on only some EU companies in relation to the security of their pension arrangements is itself anti-competitive.

While many characteristics of IORPs have been identified, there is little focus on the fact that very many (if not the majority of) IORPs are not marketing to the public and that legislation aimed at protecting customers in relation to insurance companies has no application in relation to IORPs, which may be viewed as 'safe-deposit boxes' for an employer's pension promises to its employees. This fundamental difference is also the reason why the sanctions for breaching security mechanisms under Solvency II cannot be easily adapted to IORPs (terminating activities, transferring their business to another insurance company).

The justification for legislative change – member protection – has little force if there is not to be consistency for members of all EU pension arrangements. The vast majority of UK pension schemes - a high proportion of the existing IORPs in the EU - are more akin to book reserve arrangements in that they provide security for an employer's pension promises; the major difference is that they have the added benefit of ring-fenced assets in addition to sponsor support and, in the UK, a pension protection scheme to give further protection to the employee against the risk of the employer's insolvency. In that sense, members of UK IORPs are better protected than members of book reserve schemes. Any justification for excluding book reserve schemes from prudential regulation must apply equally or more clearly to such UK IORPs since the later are already well covered by domestic and EU regulation. They should therefore be carved out from the new proposals to the same extent

	as book reserve arrangements. <u>Specific response to question 34</u> **(CfA 6 Security mechanisms) Do the stakeholders agree that Articles 87-99 of Solvency II on own funds should be applied to IORPs? What amendments, other than the ones suggested by EIOPA, should be made?** We do not support the core premise of adapting Solvency II for the generality of IORPs, or re-legislating for IORPs by reference to the single market or a level playing field with insurance companies, without a comprehensive analysis of whether the IORPs actually or potentially "act in a manner similar to insurance companies" and are genuinely and meaningfully competing or operating in the same market as insurance companies. In addition, a complete analysis of the effects of such regulation is needed. For those IORPs or other pension providers that are trading (whether or not for profit) and are soliciting customers from the general public who might instead approach an insurance company, we agree that Articles 87-99 of Solvency II could be appropriately adapted.	
35.	**(CfA 6 Security mechanisms) Do stakeholders agree that subordinated loans from employers to the IORP should be explicitly allowed in a revised IORP Directive?** Yes	
36.	**(CfA 6 Security mechanisms) What is the stakeholders' view on the analysis whether to introduce or not a uniform security level for IORPs across Europe? Do the stakeholders agree with EIOPA's decision not to recommend a specific probability? If not, what specific probability should be imposed upon IORPs?** It is inappropriate to introduce a uniform security level for IORPs across Europe. It would harm pension provision by damaging the confidence of employers and their investors (and related	

	companies who may provide guarantees) who engage voluntarily in pension provision. Employer confidence has already been damaged by repeated changes to regulation. It is also inappropriate because it will not achieve any of the legitimate aims identified. Members and beneficiaries will not have greater clarity or understanding about the security of their pensions for the reasons identified at 10.3.39: it will create only a "false sense of "uniform" security" because of benefit reduction mechanisms that may apply, as well as privilege rules and the availability of pension protection schemes and sponsor support if not included in any 'holistic balance sheet'. Further, members and beneficiaries, unlike the customers of insurance companies, generally cannot switch between IORPs, at least not in the UK where an IORP is more like a 'safe-deposit box' providing security for their own employer's pension promises. The security of IORP members is inextricably linked to the ability of their own employer to pay. There are therefore no member choices for which a uniform security level would provide useful information. We agree with EIOPA's decision not to recommend a specific probability.	
37.	**(CfA 6 Security mechanisms) Do the stakeholders agree that the confidence level should apply to a one-year time horizon?** The purpose of such a requirement must be borne in mind. What is the relevance of the information? What will be the consequences? Who will use it? What for? Pension liabilities are long-term liabilities and a one-year time horizon would generally be relevant only to a winding up of the IORP within that period (on insolvency of the sponsors or otherwise), or to transfer decisions that might be available to members and beneficiaries. It might also be relevant to supervisor action or funding requirements. However, as noted by EIOPA, imposing funding requirements in relation to a confidence level measured on a one-year time horizon will be pro-cyclical and increase volatility and economic and financial instability for the sponsors and the IORP. This will be damaging for pension provision and for businesses that sponsor them (either as	

	employers or as guarantors). A one-year time horizon may be appropriate in relation to IORPs that are soliciting customers.	
38.	**(CfA 6 Security mechanisms) What is the stakeholders' view on applying the Solvency II-rules for calculating the solvency capital requirement (SCR) to IORPs, taking into account their specific security and benefit adjustment mechanisms?** Bearing in mind the extent of existing legal and regulatory protection for pension scheme members and beneficiaries, there is no justification for changing funding measures and obligations for IORPs that provide benefits for a company's own employees and their dependants rather than soliciting customers from the general public. The damage to the confidence of employers in the fairness and stability of regulation of pensions would be significant, and would damage rather than enhance pension provision. The cost of complying with a further change in regulation would itself impact on the ability of employers to sustain good pension provision. From a UK perspective, many of the changes would affect the basis of scheme governance, since they would undermine the role of trustees. There is no justification for interference in the law in this way and it is contrary to the principle of subsidiarity. For IORPs that "act in the manner of insurance companies" and are trading and soliciting customers from the general public in competition with insurance companies it may be appropriate to use Solvency II rules appropriately adapted. We do not think that the specific security and benefit adjustment mechanisms can be appropriately taken into account as part of an SCR. It is not coherent to treat a benefit adjustment mechanism as a contingent asset in a solvency measure since it is, in fact, a pre-agreed mechanism for addressing distribution on insolvency of the IORP (as identified in 10.6.8). It is correctly described as a risk-sharing mechanism. Removing it would be a variation of the contract between the parties (members, beneficiaries and employers). We do not believe it is appropriate to treat pension protection schemes as assets of the IORP. This is	

	further discussed in response to question 41. Treating pension protection schemes and benefit adjustment mechanisms as contingent assets of the IORP could be misleading to members and beneficiaries. It muddies the distinction between the level of security for their unadjusted benefits, and the security that would be given to adjusted benefits in the event that the assets of the IORP are insufficient to cover its liabilities. Such an approach could lead to the conclusion that UK IORPs are always fully funded assuming the pension protection scheme is adequate to provide adjusted benefits. In effect it would measure only the strength or availability of the pension protection scheme. If that were to be the case, there would be no need for the rest of the security mechanisms. We agree strongly, however, that the existence of sponsor support, pension protection schemes or benefit adjustment rules should be acknowledged and this is done perfectly adequately under current IORP I and national legislation, providing good protection to members and beneficiaries. Since the system works well, its replacement by a more prescriptive variety of regulation is not proportionate regulation. Protection of customers and 'level playing field' issues do not apply to the majority of UK IORPs and are more likely to apply to entities such as NEST which do not fall within the scope of EIOPAs advice.	
39.	**(CfA 6 Security mechanisms) Do the stakeholders believe that IORPs should assess the SCR on an annual or three-yearly basis?** Three-yearly.	
40.	**(CfA 6 Security mechanisms) What is the stakeholders' view on imposing a minimum capital requirement (MCR) upon IORPs? What adjustments to the Solvency II rules are needed regarding the structure and frequency of the calculation?** For the reasons already stated, we do not think that change to the funding requirements for IORPs is required or appropriate, or likely to achieve any of the stated objectives of the European	

	Commission. The purpose of the MCR is to trigger certain supervisory actions which will protect current and future customers on the basis that they have the option of choosing another insurance company that is better capitalised. The mechanisms appropriate to insurance companies are either inappropriate or inapplicable for IORPs (e.g. transferring the business of the IORP to another IORP) or prejudicial to members (e.g. by terminating it altogether). Equivalent steps would include terminating future accrual and forcing the transfer of the IORP's 'activities' to an insurance company by winding it up. These are sanctions currently available under the UK supervisor's statutory powers. Such actions are, however, detrimental to the members and beneficiaries rather than to other parties. Because of the employer's extensive legal obligations under UK law, the compulsory wind up of its scheme is likely to push many companies into insolvency. It is acknowledged that there may be some types of IORPs or other pension vehicles, such as the UK NEST, where similar measures could be implemented without detriment to members and beneficiaries, but differentiation between (a) company specific IORPs that are security for an employer's pension promises and (b) commercial IORPs and other vehicles that are trading with the public and whose liabilities are transferable without prejudice to their customers is needed. As the objective (protecting current and future customers) and purpose (triggering certain supervisory actions that achieve such protection without detriment to the customers) of the MCR do not apply to UK IORPs, we do not think it appropriate to impose the MCR to the majority of UK IORPs because it will not serve its purpose. The UK also has experience of using a minimum funding requirement. It created a false sense of security and became a standard measure of funding that was inappropriately low. We think introducing an MCR would be a regressive measure.	
41.	**(CfA 6 Security mechanisms) What is the stakeholders' view on the analysis regarding**	

	pension protection schemes? If included in the holistic balance sheet, should pension protection schemes be taken into account by reducing the sponsor's insolvency risk or by valuing it as a separate asset? We do not agree that pension protection schemes can be treated as assets of the IORP on a holistic balance sheet. In the UK, the current pension protection scheme is not a contingent asset of the IORP. It is an additional means put in place by the UK government for protecting the members from the risk of insolvency of the employer (as required by existing EU legislation). Because such arrangements are in place, the security of members' benefits is not dependent either on the capital held by the IORP or indeed the support afforded by the sponsor. For this reason it is not necessary for UK IORPs to have the same level of capital requirements as is appropriate for an insurance company. Pension protection schemes should not go on the holistic balance sheet. Instead, their existence should correctly be recognised as a reason why IORPs that are covered by such schemes do not need to be funded like insurance companies using a Solvency II based SCR.	
42.	**(CfA 6 Security mechanisms) Do stakeholders agree that capital requirements for operational risk should be applied to DC schemes where investment risk is borne by plan members? Should these capital requirements be uniform or tailored to the actual risk profile? Do stakeholders find it sensible to distinguish between DC and other schemes in the area of operational risk?** No. Such capital requirements merely add cost for members diminishing the benefits they receive from their DC funds. Operational risk (in the form of theft, fraud or administrative error) may not ultimately lie with members or with the IORP but with external administrators or third parties and there may be many means of redress. If the risk does not lie with the members or the IORP, it is not appropriate for them to fund a reserve to cover such risks. Irrecoverable operational risk is also unlimited in amount (subject to the totality of the assets of the IORP). It is therefore difficult to determine an appropriate capital requirement and the protection provided may not be sufficient. The distinction between defined contribution and defined benefit schemes in relation to operational risk is	

	not clear.	
43.	**(CfA 6 Security mechanisms) What is the stakeholders' view on the analysis regarding the duties of IORPs and the powers of supervisors in the case of deteriorating financial conditions as introduced by Article 136 and 141 of Solvency II?** Article 136 covers the requirements for insurance companies to have procedures in place for identifying and notifying deteriorating financial conditions. The principle of monitoring and reporting changes in financial conditions can be extended to IORPs. In the UK, there are already requirements applicable to IORPs which could fall within Article 136. The challenge is in the detail. This relates particularly to the level and frequency of any monitoring, the level of investigation required, the associated cost and available supervisory actions and the need for redress or action on what may be a short term deterioration in financial conditions in relation to what are long-term liabilities. If the monitoring of short term deterioration in financial conditions results in supervisory action or increased funding obligations over the short term, this may increase volatility and pro-cyclicality in a manner that is unnecessary and harmful to pension provision overall. It is doubtful if the increased costs which will inevitably form part of such a system are justified, given existing provisions. The change could amount to change for change's sake. Article 141 (supervisory powers to protect policy holders in deteriorating circumstances). It is impossible to comment as the views expressed at 10.3.196 are too vague. We agree that any measures should be 'proportionate' and 'suitable'. Clearly what is proportionate and suitable for an insurance company marketing to the public and covering a variety of unpredictable risks will be very different to what is proportionate and suitable for conventional company IORPs. As already noted, pension liabilities are long term and predictable. Normal funding ensures that these liabilities can be met without prejudicing the health of the sponsor. The only risk of early 'hits' relates to the solvency of the sponsors. We would add that any interference with the existing financial rights of members and beneficiaries or sponsors, both employers and guarantors, needs strong justification. It is a revision of both the	

	‘social contract as referred to on 10.6.8 and the legal contracts made by private parties. Also, the purpose of benefit adjustment mechanisms that may be in place is to address deteriorating circumstances for the protection of members and beneficiaries and they strike a particular balance in terms of risk sharing and solidarity.	
44.	**(CfA 6 Security mechanisms) What is the stakeholders’ view on the analysis regarding the submission of recovery plans and the length of recovery periods as introduced by Articles 138 and 139 of Solvency II? Should the recovery periods – with regard to the SCR and possibly the MCR – for IORPs be flexible, fixed or a combination of both? What would be the reasons – if any – to allow IORPs longer recovery periods than prescribed by Solvency II?** We prefer Option 1, retaining the IORP Directive. As discussed at question 43 above, setting new funding obligations requires strong justification. There are good reasons why funding obligations for some IORPs should be flexible. Our response is focused on UK IORPs providing (or providing security for) defined benefit promises. The primary obligation of the employer and sponsor under UK IORPS that are defined benefit in nature (and their trustee boards) is to ensure that the pension promises which are made are duly delivered. The IORP, as a legally ring-fenced vehicle separate from the employer’s business, provides security against the risk of default by the employer or sponsor. Funding (the gradual setting aside of assets to meet liabilities) can and should be flexible in order enhance security for the pension promise and avoid prejudicing the sponsor and the consequent survival of the IORP. Solvency II is designed to ensure that insurance companies have sufficient capital to act as a buffer in the event of ‘hits’ to the insurance company. The nature of the insurance companies’ business is that they are exposed to a variety of risks that may create such ‘hits’. In contrast, IORP liabilities are predictable, and the main risk of ‘hits’ is the risk of an acceleration of funding obligations in the event	

	of the sponsor's insolvency. There is a real risk that fixed obligations to meet SCR or MCR over an arbitrary and unnecessarily short period could themselves create new 'hits' that cause the employer and therefore the IORP to fail. Flexibility in funding is therefore not only permissible and beneficial but also necessary. It is unnecessary and risky for these IORPs to be required to meet short recovery plans on a prescriptive basis. Given the long term nature of the pension liabilities, if solvency measures used have a one-year time-scale and high confidence levels, there will be significant volatility. This may not be damaging if long recovery period are used. If short recovery periods are used, regulation will have created artificial, pro-cyclical strains on sponsors, increasing the risk of 'hits' (i.e. defaults of sponsors) and prejudicing the survival of the IORPs and defined benefit pension provision. The detrimental impact for European business as a result hardly needs stating. The purpose of the recovery plan must be considered. Under Solvency II, recovery plans to the SCR and MCR are intended to protect current and future customers by ensuring that they are protected from trading with insurance companies which have insufficient buffers to withstand the various risks to which they are exposed. Such risks include a range of unexpected events creating liabilities or 'hits'. Specifically, the failure to comply with a recovery plan (particularly in respect of the MCR) can trigger supervisory action such as requiring the insurance company to cease its activities and to transfer its business to another insurer. For a UK IORP, similar supervisory powers already exist (related to current IORP Directive funding requirements), i.e. the supervisor can require termination of benefit accrual for existing and new members in the event of a breach of funding requirements and can force the transfer of liabilities not to another IORP but to an insurance company or the UK pension protection scheme. However, if short term or fixed recovery periods were used or recovery plans to a lower and more rigid MCR were used, these supervisory powers would come into play more frequently because of the volatility and pro-cyclicality of such funding measures. We believe this is netiher proportionate nor suitable. It would lead to a reduction in pension provision at least on a defined benefit basis.	

	We recognise different considerations may apply in relation to DC IORPs and IORPs and other pension vehicles, such as UK NEST, which act like insurance companies in selling annuities and long term investments to the public.	
45.	**(CfA 6 Security mechanisms) Do stakeholders agree that the IORP Directive should be extended with stipulations introduced by Article 137 and 140 allowing supervisors to prohibit the free disposal of assets when IORPs do not comply with the capital requirements or the rules for establishing technical provisions?** We are not clear as to what is intended by a prohibition on the free disposal of assets. If the prohibition applies only to the assets of the IORP, this should cause no difficulty in theory, although practical difficulties in investment management contracts can be envisaged and the terms of such contracts would need to be reviewed. The result might be a loss of opportunity to the IORP which could actually be detrimental. If it is redefined as suggested in 10.3.195 as a restriction on discretionary increases, it should cause no difficulty. If the prohibition applies to assets within the holistic balance sheet (i.e. assets of the sponsors, including employers and guarantors), it is a significant interference with corporate activity and with the property rights of those sponsors and would need strong justification. Such a change would go well beyond the prudential regulation of IORPs and involves wider issues of corporate and insolvency law and international law (guarantors of UK IORPs are often located elsewhere in the EU but may be located outside the EU). Legal challenges can be expected and the reputation of the EU as a place to invest and to do business would inevitably be damaged. Any concept of 'free disposal of assets' would need to be tightly defined as to what constitutes free disposal of assets (gifts only, exercise of a discretion on pay rises, disposal of business assets for value).	
46.	**(CfA 6 Security mechanisms) Do stakeholders agree that it should be specified in the IORP**	

	Directive what constitutes a recovery plan as introduced by Article 142 of Solvency II? How should the contents differ from those of insurance companies? We agree that a requirement for a recovery plan may specify what constitutes a recovery plan and that the provisions of Article 142 (1) could be adapted to the specificities of IORPs. We also agree that Article 142(2) could be adapted to the specificities of IORPs assuming Article 39 were also adapted. However, the wrong provisions could clearly do more damage to pension provision overall. We would emphasise that the usefulness or relevance of such certificates and such provisions depends on: who receives them, the ability of current and future members and beneficiaries to withdraw from the IORP and apply to an alternative IORP (why would another company wish to allow another's employees to join its own scheme?), their content, the relevance of the funding level used (SCR, MCR or current IORP Directive measure) and of the recovery plan to the security of the benefits provided under the IORP. The contents of the recovery plan should differ from those used for insurance companies by: • Referring at (b) to income and expenditure of the IORP, namely contributions, annuities and other income sources receivable and pensions and other benefits, levies and taxes payable; • Referring at (d) to the assets of the IORP and other (conditional) commitments, escrows and guarantees and the availability of any pension protection scheme; • Referring at (e) to the statement of funding policy.	
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53.	**(CfA 9 General principles of supervision, scope & transparency & accountability) Do stakeholders agree with the principle that the material elements of the Solvency II requirements in respect of the general principles of supervision, and in relation to transparency and accountability should also apply to IORPs?** No	
54.	**(CfA 9 General principles of supervision, scope & transparency & accountability) Has EIOPA identified correctly those issues – need to enhance benefit security, differences between IORP and insurance supervision, and diversity of IORPs - where there should be differences between insurers and IORPs on supervision and transparency and accountability?** The issues have been correctly identified, although we would question whether there is actually a need to enhance benefit security given the extensive levels of protection already accorded to members and upgraded to the UK since the determination in *Robins v Secretary of State for Work and Pensions* (2007) C-278/05, and the need to address other policy objectives.	
55.	**(CfA 10 General supervisory powers) Do stakeholders agree with the recommendation that supervisory authorities should have broadly the same powers to require IORPs to conduct stress tests as it has in respect of insurers?** No	
56.	**(CfA 10 General supervisory powers) Do stakeholders agree with reinforcing the sanctions**	

	regime for IORPs? No. The approach suggested is wholly out of balance with regard to the need for member security and the health of the employer which (voluntarily in most cases) provides pension benefits. The principal risk for members' benefits in a UK defined benefit IORPs is the risk of weakening the employer by unnecessary additional costs or unnecessary acceleration of funding liabilities and the ultimate insolvency of the employer. A failure to manage this balance is therefore likely to damage the interests of the members. It will also reduce, not enhance, pension provision.	
57.	**(CfA 10 General supervisory powers) Should knowledge of the imposition of penalties be public or restricted?** No. As we have repeated, companies providing benefits for their employees are not the same as companies going to the market to sell products to consumers. The proposed regime is inappropriate as a whole. If such sanctions were to be applied and then publicised the share price of the company would in all likelihood be materially affected, and the company immediately weakened. As adverse effect on the security of pension scheme members as employees, as well as pension scheme members, is likely to be the result.	
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59.	**(CfA 11 Supervisory review processes & capital add-ons) What is the view of stakeholders on whether the requirements for the supervisory review process for insurers should also apply to IORPs?** EIOPA recommends that Article 18 in the IORP directive should be simplified, with several existing provisions removed such as Article 18(5)(c), which permits investment in "risk capital markets". Equally, the draft response suggests Article 18(1)(d), referring to investment in derivatives, should be either deleted or clarified. Instead, EIOPA says member states can rely on current safeguards such as the "prudent person" rule in Article 18(1) and the ability for individual states to impose further investment restrictions under Article 18(5). While EIOPA favours retaining the prohibition on	

	borrowing by IORPs in Article 18(2), it seeks clarification that this only applies to direct borrowing and does not cover subordinated loans. Although the proposals to clarify the Article 18 investment rules are sensible, EIOPA does not put forward any measures to clarify the apparent contradiction in Article 18(1)(b), which requires assets to be invested "in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole". These individual goals are impossible to reconcile collectively.	
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61.	**(CfA 12 Supervision of outsourced functions & activities) Do stakeholders agree that the material elements of the requirements on insurers in respect of supervision of outsourcing should apply also to IORPs?** No. As indicated above, the responsibility for schemes in the UK is in the hands of trustees with fiduciary responsibilities. They are clearly accountable in relation to the choice of counter-parties, and the employer will bear the cost of anything which goes wrong. Consequently, there is both accountability and restitution of funds within the current system. It would be completely inappropriate for regulatory interference within a company pension arrangement at this level.	
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63.	**(CfA 13 General Governance Requirements) Do stakeholders agree with the principle that the material elements of the Solvency II requirements for governance apply to IORPs, subject to proportionality?** No. The implication here is that larger pension schemes should be subject to these requirements, but that smaller schemes should not. The point is that there are already detailed governance requirements for all company schemes within the UK which broadly work well, and which do not need an additional level of supervision. We repeat the point we have made throughout this evidence, which is that companies and trustee boards devise arrangements within a strictly policed regulatory system, which are suitable for the particular needs of the scheme and the employer and give due weight to member protection.	

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77.	**(CfA 19 Actuarial function) Are the requirements of solvency II the correct starting point for the actuarial function?** No. The purpose of the actuary in relation to company pension schemes is to ensure that a level of funding is maintained which is adequate within a prudent framework to provide the benefits as they fall due.	
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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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