Comments Template on Discussion Paper on Sponsor Support Technical Specifications		Deadline 31 October 2013 18:00 CET
Name of Company:	Towers Watson UK	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
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Reference	**Comment**	
General Comment	Towers Watson welcomes the opportunity to comment on this discussion paper. Whilst we welcome it as a more pragmatic approach to sponsor support valuation than had been the case under the rushed 2012 QIS, we still consider such a valuation as largely unnecessary, potentially administratively burdensome and with costs that are disproportionate to any benefit. However, we recognise the key role that sponsor support would play if an Holistic Balance Sheet were used as a risk management tool for IORPs. As set out in our letter to M. Michel Barnier in June 2012 http://www.towerswatson.com/de-DE/Press/2012/06/~/media/Pdf/Press/2012/06/IORP-Directive-Review.ashx?UniqueValue=43478137330264890 we consider that having	

	sponsor support as a 'balancing item' in the HBS would be the best approach. It appears, however, that EIOPA has decided that an HBS construct *will be* used as a snapshot of the capital adequacy/security of IORPs. It is, therefore, critical that any valuation of sponsor support for this purpose is sensible in the context where sponsor support is significant to the ongoing and future well-being of the IORP. It is also very important that any valuation of sponsor support is developed in a rigorous manner, with appropriate quantitative and qualitiatiive impact studies being carried out, in order to avoid exposure to any reputational risk. We note that the EIOPA executive considers the HBS as providing a means of *comparing* pension systems of different Member States. This may be the case superficially. However, the different benefit adjustment and security adjustment mechanisms used in different Member States means that such a comparison has little meaning beyond a purely academic exercise. Moreover, comparability has been put forward as a mechanism to enable greater member choice. Such choice is illusory – members do not have choice, beyond whether to join or not join their employer's occupational pension. In some countries, even this limited choice is unavailable. To be clear, our objection here is not in the validity/use of a HBS assessment as a *risk management* tool, rather the notion that this has material benefit as a means of comparison of the security of pension promises between Member States. In essence, therefore, we believe the HBS <u>can</u> be a useful risk management tool both for those responsible for running IORPs and the relevant national competent authorities. At a general aggregate level there may also be some oversight benefit for EIOPA. The HBS is necessarily an historic snapshot – as is the case with existing IORP valuation regimes. We do not underestimate the usefulness of such	

	assessments, particularly in helping communicate the funding position to members and beneficiaries. However, the matter of proportionality is of great importance. We would hope, for example, that EIOPA agrees that there is no benefit to carrying out a *sponsor support assessment* for pure defined contribution IORPs. Likewise, the cost of carrying out an holistic balance sheet assessment at all for such IORPs is unwarranted. For IORPs with some defined benefit promise, the point at which an HBS and sponsor support assessment is necessary needs to be set such that it does not impose a cost that is disproportionate to the benefit. Indeed we would argue that for many, possibly all, defined benefit IORPs there is little benefit in trying to place a <u>single number</u> on the value of sponsor support, which is why (as mentioned above) Towers Watson refers to having sponsor support as a ‘balancing item’ in the HBS – as was set out in our letter to M. Michel Barnier in June 2012 referred to above. This ‘balaning item’ approach would enable those running IORPs and national competent authorities to exercise judgement in deciding whether the extent of the reliance on the sponsor was appropriate - taking account of all factors, which may for example include non-financial aspects such as the legislative framework within which the sponsor operates. We also believe this approach to be closer (than EIOPA’s proposals) to the approach that has evolved in the marketplace: i.e. the current practice of using qualitative categorisation of sponsor support such as ‘very strong’ or ‘weak’.	
Q01.	**Should IORPs be provided with additional guidance for conducting stochastic valuations of sponsor support?** In general we believe that the sheer diversity of IORPs means that adopting a principles-based approach is the only way to avoid imposing requirements and guidance that are out of proportion to the risks being managed. In practice we suspect that the only IORPs who will conduct stochastic	

	valuations will be those who are currently using stochastic techniques. (We believe that these are largely IORPs based in the Netherlands.) We therefore believe that the level of expertise of those attempting stochastic valuations will be high and consequently, in our view, that any additional guidance should be limited to addressing any questions of clarification that cannot be resolved by the local supervisory body. An ongoing 'FAQ' section on the EIOPA website may be an appropriate approach to providing such clarification	
Q02.	**Should IORPs be provided with additional guidance for conducting valuations of sponsor support using either Simplification 1 or 2? Should either of these simplifications be removed or should any other simplification be developed?** In general we believe that the sheer diversity of IORPs means that adopting a principles-based approach is the only way in which to avoid imposing requirements and guidance that are out of proportion to the risks being managed. We are therefore not in favour of changes to guidance that goes beyond correcting, clarifying and consolidating existing guidance text. We anticipate that IORPs that currently use stochastic techniques (e.g. in the Netherlands) will favour Simplification 1 and that others (e.g. in the UK) will use Simplification 2. We would therefore argue for including both simplifications for the purposes of a QIS but then to ensure that the data collected makes it clear which approach has been followed. We are strongly of the view that further work is required not only to develop principles-based simplifications of the current approach further but also alternative approaches.	
Q03.	**In the stakeholders' view what role should the concept of maximum sponsor support play in the general valuation principles for sponsor support?** We advocate replacing sponsor support with "reliance on sponsor" as a	

	balancing item in an holistic balance sheet. The idea is that this would allow the multi-dimensional nature of sponsor support to be captured by assessing the reasonableness of the IORP's capital base by comparing this "reliance" metric against all the relevant measures using weightings that are appropriate to the circumstances of the IORP at the time. Such an approach would avoid the need for the concept of a single, uniquely-defined "maximum sponsor support" number. In the absence of a proposal based on "reliance", we would consider that EIOPA should investigate further the advantages and disadvantages of counting sponsor support as ancillary own funds. Of course a "maximum sponsor support" would then be required. However, for the purpose of a QIS based on the approach set out in this discussion paper, we see little to be gained from including the concept of maximum sponsor support. Indeed we see the main advantage of the approach as doing away with the need to calculate maximum sponsor support.	
Q04.	**Is wage an appropriate additional measure for estimating the maximum amount of sponsor support? If so, please explain why? Are there any other measures which could be used to assess the maximum sponsor support?** Many UK IORPS closed to new entrants some years ago and this is likely to make a wage-based measure unsatisfactory however it is defined. Even so, we recognise that there may be IORPs with thousands of participating employers for which wage is the only reliable metric on which to base an assessment of sponsor support.	
Q05.	**Are stakeholders comfortable with the concept of linking default probabilities, credit ratios and sponsor strength?** We are comfortable with a QIS based on this approach as this may generate some interesting new information. However, although we think the concept of	

	default risk is useful in this context, we strongly believe that the nature of a “default event” relative to the financing of an IORP is materially different from a credit default and that this needs to be reflected in the calibration of the model. We also have a concern that it may not even be possible to put a meaningful single number on the risk of sponsor support default and we urge EIOPA to conduct further research on this point.	
Q06.	**Do stakeholders agree with exploring the possibility of including a standard table in the technical specifications that links credit ratios with default probabilities?** We agree that a QIS based on this approach may yield some interesting new information and improve the quality of aggregate data. However we would be concerned if such an approach were followed in new legislation relating to the capital requirements for individual IORPs unless there were considerable scope to make adjustments to the tabulated values to reflect the particular circumstances of each individual IORP on a “comply or explain” basis. We recognise however that allowing for this level of flexibility in the context of the large numbers of IORPs in the UK and Ireland could result in a substantial increase in the complexity and therefore cost of the supervisory role.	
Q07.	**Do stakeholders have other suggestions to derive default probabilities of the sponsor and to reduce reliance on credit ratings?** Our expertise is not in this area. However we see the definition of default and the calibration of default probabilities as key to a regulatory structure based on “market consistency” and therefore urge EIOPA to research these aspects thoroughly.	
Q08.	**Do stakeholders agree that timing of sponsor support reflecting the affordability of making additional payments could be an improvement to the general principles for valuing sponsor support?** We think it crucial that “affordability” be defined carefully so that it accurately reflects the resources on which an IORP can realistically draw: i.e. that it	

	neither overstates affordability by hypothecating that all the sponsor's resources would be made available nor understates affordability by failing to give appropriate credit for the resources that may be available from other entities within the corporate structure or future growth of the sponsor.	
Q09.	**Do stakeholders think that limited conditional sponsor support should be valued and included on the holistic balance sheet? Should it be included separately?** We consider that the asset valuation should be compatible with the liability valuation and, in some cases, this may mean recognising the value of limited conditional sponsor support. However we believe that this should be done in a way that properly recognises the likelihood of that support being provided.	
Q10.	**Should more detailed guidance be provided in future technical specifications to value sponsor support that is subject to discretionary decision_ making processes? If yes, please explain in what way. Could the suggested detailed guidance also be applied to benefit adjustment mechanisms that contain discretionary elements?** We believe that the sheer diversity of IORPs means that adopting a principles-based approach is the only way to avoid imposing requirements and guidance that are out of proportion to the risks being managed. We therefore believe that, in general, providing detailed guidance would be an unhelpful departure from the principles-based approach. We believe that any assistance required in interpreting the principles in the context of local conditions should be provided via a local supervisor.	
Q11.	**Please provide your general comments on the alternative approach.** We recognise that the proposed alternative approach is a step forward in improving the quality of the data that may be yielded by a QIS. However, whilst it may be that a QIS based on this approach would provide better aggregate data than has been collected to date, we have yet to be persuaded	

	that the approach would form a sound basis for a capital requirement for individual IORPs.	
Q12.	**Does the alternative approach address the concerns raised during the previous consultation on the technical specifications?** No- our primary concern is that the concept of placing a single value on sponsor support is simply not fit for the purpose of specifying capital requirements – it represents an oversimplification that will mask important risk management information. In the context of a QIS we would be concerned that too much emphasis is being placed on objectivity and harmonisation at the expense of reliability of the estimate of the value of sponsor support. We believe that professional judgement, while subjective, has an important role to play in improving the reliability of such estimates. The alternate approach also introduces new concerns about whether the metrics suggested capture the quality of credit and the likely position of the IORP in case of sponsor default. We consider that a more powerful and more robust approach would be to identify "reliance on sponsor" as a balancing item in the holistic balance sheet and then to manage that "reliance" by reference to the full range of sponsor support metrics relevant to that sponsor.	
Q13.	**Are there any areas that have not been addressed adequately enough?** We favour a principles-based approach. We suggest that more could be done to articulate the valuation principles in a way that makes them easy to apply to non-standard situations, which are common.	
Q14.	**Are IORPs still likely to want to calculate a maximum value of sponsor support (even if not required under the alternative approach)? If so, for what purpose?**	

	No. We see no advantage in calculating a maximum value of sponsor support (under the alternative approach) if it is not required and consequently would expect few, if any, IORPs to calculate this figure if it is not required.	
Q15.	**Do stakeholders have other suggestions to adjust these ratios to cater for different sectors?** No – this is not our field of expertise.	
Q16.	**Does Stage 1 contain enough information and guidance for IORPs to calculate a credit strength that is proportionate for QIS purposes?** As noted in our response to Q13, we believe that more could be done to articulate the valuation principles but otherwise we do believe that there is enough information to calculate a credit strength that is proportionate for QIS or other purposes. However it really isn't possible to form a judgement about what may or may not be proportionate for other purposes without knowing what the results may be used for and the regulatory responses that may arise from them.	
Q17.	**Does Stage 1 contain enough guidance for IORPs to do their own calculations if they believe this is appropriate for them to do so?** Although it will still be necessary to interpret the guidance, leaving open the possibility that two practitioners may reach different conclusions about what it means or requires, we consider this to be unavoidable in this context and preferable to a more prescriptive approach.	
Q18.	**Are Income Cover and Asset Cover suitable credit ratios to use for Stage 1?** For most entities that sponsor IORPs we would agree that, in principle, income cover and asset cover are among the statistics that ought to be taken into account. However we would point out that it is future income cover and future asset cover that is most relevant. It follows that the value placed on sponsor support will be more reliable if ratios based on historic data alone are	

	appropriately adjusted whenever there is additional information available that may be used to improve their reliability as predictors of future income cover and future asset cover. In particular it may be appropriate to adjust these ratios to reflect the quality/uncertainty of the revenue and the fungibility of the assets in a recovery scenario.	
Q19.	**Are the parameters used to determine sponsor strength in Table 4 appropriate?** We welcome EIOPA's attempt to provide a simple method for determining sponsor strength. We note that the parameters in Table 4 are for illustrative purposes only. We expect that there will be some sponsors for whom they are appropriate. However we think it would be helpful if paragraph 59 were expanded to make clear that the particular calibration of these parameters set out in Table 4 should be adjusted if the quality of the income cover or asset cover is particularly strong or particularly weak.	
Q20.	**What other definitions of earnings or net assets could be used in sectors where the standard definitions are not appropriate?** This is not our field of expertise but we urge EIOPA not to attempt to provide detailed guidance on this because doing so would impose on all IORPs the burden of having to digest many pages of guidance that are barely relevant to them. Instead it should be sufficient and more robust to articulate the relevant valuation principles clearly.	
Q21.	**Are the periods shown in Stage 2 appropriate (bearing in mind this is for QIS work only, and not to determine a policy response)?** In general, and solely for the purpose of a QIS, these periods may be reasonable. However we question whether the sponsor strength rating is the relevant metric for determining the contribution payment periods and we suggest that EIOPA consider whether income cover alone may be a more appropriate indicator.	

Q22.	**Do you agree that time periods for contributions for the QIS calculations for sponsor support should be based on affordability or should they be based on willingness/obligation to pay?** Both assessments would be potentially useful but we would consider the former to be more significant.	
Q23.	**To what extent are there any IORPs whereby sponsor contributions cannot exceed certain limits (even if contributions are affordable)?** We are not aware of any UK IORPs that have been set up with "hard-coded" limits of this nature but there are number of scenarios in which the practical consequences of the circumstances of the IORP at the time may have the same effect. For example if the total contribution is shared between sponsor and member in fixed proportions (such as in the UK's Railways Pension Scheme), affordability may be limited by what members can afford and it needs to be borne in mind that if contributions increase, members may opt out of the IORP with the result that each remaining member then shoulders an increased deficit burden. (Moreover, the member who leaves the IORP is then less likely to have adequate income in retirement.) There are also some IORPs where the sponsor is no longer able to make contributions at all (following insolvency, for example) but the IORP is continuing. This may happen, for example, if the IORP liabilities exceed the capacity of the insurance markets. For the avoidance of doubt, in such a situation there is no party from whom any additional funds/capital can be obtained.	
Q24.	**Are the annual probabilities of default appropriate for future QIS purposes? If not, why not?** The concept is acceptable but the limitations of the proposed approach, and their implications for the validity of the results need to be properly understood.	

	We note, for example, that: • Assuming the same probability applies independently from one year to the next is a very strong assumption that is unlikely, in many cases to be market consistent. • The nature of the default event whose probability is reflected in market measures is almost always significantly different from the nature of a default in sponsor support that would limit an IORP's likelihood of paying the pension promised.	
Q25.	**Do stakeholders have any comments on stage 3?** We note that these hypothetical contributions are calculated with no allowance for default. This reflects common practice but has the rather unsatisfactory consequence that when these contributions are valued with an allowance for default, that value will be less than the value of shortfall with the potential consequence that any IORP with a shortfall on this basis will appear undercapitalised despite the sponsor support.	
Q26.	**Is it reasonable to not allow for any recoveries from sponsor defaults? Please provide examples where this could increase the calculated value of sponsor support.** No. The results of the calculation are very sensitive to this parameter and in practice there are a wide range of possible outcomes. A QIS that failed to capture the impact of this variation is most unlikely to produce something that can be relied upon for making decisions about the capital position of IORPs across Europe. We doubt that it will be possible to codify the calculation of a recovery rate in detail because this would require all the variations in insolvency practice that affect IORPs to be captured, which we suspect would create a huge burden of guidance that IORPs would need to understand in order to identify the small part relevant in each case. Yet again we find ourselves arguing for a principles-based approach for any legislation on this point. In the meantime we would ask: 'Has EIOPA considered basing the	

	recovery rate for the QIS on the asset cover ratio?'	
Q27.	**Is it appropriate to do separate calculations to allow for sponsor support from other group companies (both for legally enforceable and not legally enforceable support by group companies)?** Yes, in fact it is essential otherwise any conclusions that may be drawn about the capital position of IORPs across Europe would be unreliable. However, EIOPA and the Commission should resist any temptation to prescribe how this should be done. Rather they should, again, provide principles-based guidance and leave IORPs to assess this for themselves – perhaps with a provision that the results could be shared with national competent authorities. (For the avoidance of doubt, we see no reason for this to then be shared with EIOPA in anything other than aggregate form.)	
Q28.	**Should any other guidance be included on how to allow for sponsor support from other group companies?** In general we believe that the sheer diversity of IORPs means that adopting a principles-based approach is the only way in which to avoid imposing requirements and guidance that are out of all proportion to the risks being managed. We therefore believe that any additional guidance should be limited to addressing any questions of clarification raised in responses to this discussion paper.	
Q29.	**What could be other valid reasons why the IORP should or should not take the financial position of the wider sponsor group into account when assessing the sponsor's financial position?** In general we believe that there should be an assessment of all the capital on which an IORP could draw. Where such reliance is not enforceable (either directly through the courts or indirectly via the powers of national competent authorities to require payment, it would be appropriate to adjust for the likelihood of payment. Appropriate credit should be given where there is a	

	track record of payments but a downward adjustment may be appropriate if, for example, the sponsor has a track record of addressing poor experience via mechanisms other than by increasing contributions or of changing relevant parts of the corporate structure without reference to the IORP managers. Subjective adjustments may be appropriate if there is good reason to believe that the future corporate structure may be materially different from the current structure.	
Q30.	**Is the approach to determining the loss-absorbing capacity appropriate?** We believe this treatment of loss-absorbency flows naturally from the alternative approach to valuing sponsor support. However we consider it unhelpful that the term “gross SCR” is used throughout paragraph 96 to mean an adjusted value. It would be better to define a new term that excludes: 1) the loss-absorbing capacity of benefit adjustment mechanisms that take precedence over sponsor support and 2) the SCR amounts relating to sponsor support We believe that more consideration is needed as to how the value of sponsor support could be affected by the shocks considered for the SCR, in particular the interest rate and equity shocks would be expected to be strongly correlated with factors impacting the quality of sponsor support. It is unclear if the current proposed approach is market consistent in this respect.	
Q31.	**Should any other sensitivity analysis be considered?** We question whether it might be instructive for the purpose of the QIS to test sensitivity to income cover and asset cover bearing in mind that we suggest elsewhere in this response that recovery period and recovery rate respectively might be better linked to these separate statistics rather to the combined “sponsor strength” metric.	
Q32.	**Are there any other types of sponsors that should be included?**	

	EIOPA should consider the possibility that the sponsor's domicile may be in a country that does not require the sponsor to disclose adequate information for the alternative approach to be followed.	
Q33.	**What additional work should be carried out if this methodology was to be used for determining sponsor support in a regulatory or supervisory environment?** EIOPA needs to investigate the costs of performing these assessments across a reasonable range of IORPs in each relevant jurisdiction. We find that individual IORPs currently take the view that even the costs associated with carrying out QIS calculations cannot be justified with the result that this vital evidence (i.e QIS results) is therefore absent. It may therefore be necessary for the Commission/EIOPA to fund this research. EIOPA needs to test how the results of the alternative approach vary over time in order to understand how robust it is: a regulatory regime that is fit for purpose without adjustment only in benign market conditions is not satisfactory.	
Q34.	**What other improvements could be made to the suggested approach?** All our suggestions are given in our responses to earlier questions in this template.	
Q35.	**Are there any aspects of the suggested approach which are unclear?** Yes, it remains unclear how the output of the suggested approach will be used and without that information it is impossible to assess whether the methodology and the corresponding results will be proportionate and fit for purpose.	
Q36.	**How could the average financial strength of an industry be determined?** We assume this question relates specifically to assessing the financial strength	

	of the sponsor support for an industry-wide IORP. Our view is this scenario lends itself to a stochastic approach rather more than IORPs with relatively few sponsors. The proposition that sponsor support could be based on average financial strength needs to be thoroughly tested – we are somewhat sceptical about it. A pragmatic alternative may be to group the employers participating in industry-wide IORPs and then to treat the IORPs as multi-employer IORPs with each group treated as an individual sponsor whose credit ratios are based on aggregated data.	