EIOPA-OPSG-12-08

19 July 2012

OPINION of the EIOPA Occupational Pensions Stakeholder Group regarding EIOPA Consultation Paper - Draft Technical Specifications: QIS of EIOPA's Advice on the Review of the IORP Directive

(EIOPA-CP-12/003, 15 June 2012)

Introduction and legal basis:

In April 2011 the European Commission asked EIOPA for advice by mid-December 2011 and later extended to mid-February 2012 on the EU-wide legislative framework for IORPs.

The Call for Advice stated that the Commission's proposal to review the IORP Directive will be accompanied by an impact assessment which will take into account the fact that supplementary occupational pension schemes are generally proposed by employers to their employees on a voluntary basis and that any new supervisory system for IORPs should not undermine the supply or the cost efficiency of occupational retirement provision in the EU.

As such EIOPA was also requested to prepare a quantitative impact study of its advice with a view to informing this impact assessment. The aim of the QIS was set as twofold:

- First, to provide all stakeholders with detailed information on the quantitative impact of EIOPA's advice on the prudential balance sheets of IORPs.
- Second, to collect quantitative and qualitative data to support the analysis of different policy options in the impact assessment of the Commission.

The EIOPA Occupational Pensions Stakeholder Group's competence to deliver an opinion towards the EIOPA Draft Advice on the IORP directive revision is based on Article 37 of the EIOPA Regulation (1094/2010/EC).

The EIOPA Occupational Pensions Stakeholder Group is hereby providing it's contribution to the EIOPA comments with regard to the EIOPA consultation paper on draft technical specifications for the quantitative impact study (QIS) of EIOPA's advice to the European Commission on the review of the IORP Directive.

The EIOPA Occupational Pensions Stakeholder Group reaffirms its commitment to contribute to EIOPA consultations in order to ensure EIOPA Advice to European Commission on the review of Directive 2003/41/EC will have a strong contribution to future regulatory/legislative developments relevant for EU wide legislative framework for IORPs.

General observations regarding EIOPA draft Advice:

EIOPA Occupational Pensions Stakeholder Group reaffirms its belief that the European IORPs should provide adequate, sustainable and safe pensions. As the White Paper on Pensions acknowledges, a holistic approach to pensions is necessary to achieve good pensions across Europe, now and in the future. The OPSG welcomes the recognition of the fact that the risks of IORPs differ from insurance companies. Therefore it follows that the revised IORP Directive cannot be directly copied from the Solvency II Directive.

The proposed Holistic Balance Sheet (HBS) approach theoretically seems to offer possibilities to take the specific characteristics of IORPs into account, although it is very complex. This method is new and more work and analysis is necessary in order to judge if the HBS approach is suitable as a supervisory tool. In our reaction on the Call for Advice, the OPSG expressed doubts about the practicability of the HBS approach. A less constrained timetable for EIOPA to test the concept of the HBS will definitely contribute to the quality of a revised IORP Directive. The OPSG would recommend the European Commission give more time to EIOPA to complete this process.

The OPSG does not believe that one QIS, based on the proposed Technical Specification, will provide the necessary information on which to draft a new Level 1 IORP Directive. Or the other way around: it seems not to be a responsible decision to base the IORP II Directive on the results of this QIS. If the Commission's goal is to support role of private pension provision[1] , then more time and more QISs will be required in order to design a Directive that serves this purpose.

The request of the European Commission to EIOPA to come up with appropriate and adequate technical specification in such a tight timetable is very ambitious. The OPSG would like to point out that it has its concerns with respect to the speed of this process in combination with the complexity. It will be difficult for EIOPA to come up with a single supervisory framework for IORPs. There are material differences between pension systems across Europe, such as the form of the benefit, the way the benefit is funded, the security level of the pension promise (which is part of the pension contract) and the involvement of social partners. As a consequence, such differences make it difficult and often conflicting to apply one legislative framework over current competent and functioning pension systems. It should be noted that in many Member States, their pension systems are either in a nascent stage of development or undergoing reconstruction in order to find a new balance between the three pillars. A harmonisation of second pillar structures across Europe does not fit with these processes. Much of the human and financial resources required for the QIS project are already committed to the above development and reorganisation. The OPSG wants to highlight that HBS approach (as described) will lead to an additional burden for these IORPs, while it is questionable how useful the concept and the QIS exercise will be given the changes in those Member States.

The revision of the IORP Directive – and especially this consultation – is a very technical exercise. Whilst the technicalities are very important, they should be subordinate to the overall goals of the European Pension Policy. Initial comments of large European companies who sponsor their own pension funds as HR vehicles indicate that the QIS and its complexity is well beyond their capabilities. It would be counterproductive if the new IORP Directive became the catalyst that led to scaling back second pillar pension provision or to move the pensions outside the scope of the IORP Directive (moving back to first pillar pensions, shift to book reserves or individual defined contribution schemes). This is undesirable, given the fact that only 40% of European employees are currently participating in a supplementary pension scheme and the recognised need for more supplementary pensions in Europe (see also EC White Paper on Pensions). If supervision of the second pillar IORPs becomes too inflexible it will increase the pressure on the first pillar, which according to the Commission is already under stress in many countries.

Therefore, the OPSG very much welcomes the Quantitative Impact Study of EIOPA and the impact assessment by the Commission in order to avoid adverse consequences to the revision of

[1] European Commission White Paper – An Agenda for Adequate, Safe and Sustainable Pensions – COM(2012) 55 final pp 9 & 13.

the IORP Directive. EIOPA has an important task to facilitate these impact studies and the OPSG is ready and willing to assist EIOPA with this challenge. Especially the proposed adoption of the HBS; this innovative approach for the quantification of security and benefit adjustment mechanisms needs further development, in order for it to succeed as an effective and affordable supervisory instrument.

Even though the QIS intends to look at the valuation of pension liabilities and capital requirements, it does not include very important elements of the prudential framework: like recovery periods, tiering of assets and liabilities and the required policy reaction if an IORP hits a supervisory trigger point, nor indeed the trigger points themselves. These (re)actions will decide the impact of the capital requirements on the European economy, since they will decide what should happen with (sponsor) contributions and pensions (and indexation) and also what the consequences will be for the investment strategy of IORPs. It could be that excessively risk-averse regulation will force IORPs to de-risk, putting the Europe 2020 strategy under pressure, because the availability of risk capital will diminish. The secondary impacts of a new regulatory framework should not be overlooked. Insurers across Europe have already changed their asset mix and sold equity as a result of the upcoming Solvency II regulation.

Unfortunately, the OPSG thinks that the proposed Technical Standards of the QIS will not provide the necessary information required to frame a revised IORP Directive. The current set of technical specifications leaves too much scope for interpretation. This questions the consistency of inputs and consequently the quality of the results. Furthermore, the OPSG is of the opinion that the first QIS is too technical. We believe that more QISs will be necessary. This first QIS should be KISS (keep it short and simple) and not a QUIZ with many possible and unclear answers. Therefore we recommend that the European Commission gives more time to EIOPA to do their QISs.

The OPSG would like to highlight three specific points of concern with respect to the QIS: 1) process, 2) the valuation of HBS and 3) proportionality.

<u>1) Process</u>

- The OPSG suggests performing more QISs (in the sense of KISS) before the European Commission sets out its proposals for the revised IORP Directive. The first QIS should be simple and increase in sophistication with each subsequent QIS – the product of an iterative learning process. More QISs will lead to higher stakeholder involvement and a better understanding by IORPs, Commission, Parliament and supervisors on how to shape the revised IORP Directive.
- Furthermore, the OPSG wants to point out that the proposed QIS will not predict or condition behaviour for the following reasons:
  - A comprehensive assessment requires not only the parameters, but also the proposed supervisory prudential framework. Key supervisory features such as the length of recovery plans (short and long term), the tiering of assets and liabilities that will decide the impact on the policy actions when an IORP hits a supervisory trigger point are missing. EIOPA also remarks on this point (I.4.2).
  - The capital requirements in themselves are less relevant than the consequences on contributions and pensions. It is unclear what the impact on these will be.

- These consequences for contributions and pensions will have an impact on the economy. We understand this the broader impact of introducing IORP II will be considered by the European Commission in their economic impact assessment. However, the Commission will not be able to perform an impact assessment for the economic consequences without knowing how IORPs will react (contributions, pensions) within the supervisory prudential framework.
- It will also be unclear what the possible consequences will be for IORP investment strategy. It is very possible that the new Directive will force IORPs to de-risk their portfolios (a secondary impact on insurance companies from Solvency II), leading to less risk capital being available for the European economies and adversely impacting on the Europe 2020 strategy. We cannot foresee how the Commission will capture and measure all these impacts.

- The representativeness of the QIS is insufficient for an IORP II proposal by the EC (see question 1). Furthermore, in some of the eight participating Member States the QIS will not be performed by IORPs, but by supervisory authorities, who will submit aggregate data. It is our opinion that EIOPA and the Commission can only gain a reliable indication of the real impact of the QIS when it is performed by IORPs. The use of aggregated data makes the comparison between funds and countries meaningless. EIOPA will find it very difficult to gain an adequate overview of this project without being aware of the moving parts that lie beneath the data.
- The timetable is too constrained. Supervisors and the pension sector have very limited experience with the concepts and valuation of the HBS. As EIOPA mentioned in its consultation, "this QIS represents the first impact study for IORPs and covers a very broad range of issues that are in many respects new concepts for IORPs, pension supervisors and other stakeholders alike". If stakeholders were given more time to react to the proposed technical standards, then the quality and breadth of the response would improve, and consequently the final outcome. The OPSG does not see the added value of shortening the consultation period due to the imposition of an external timetable (I.10.1). The advantage of a better response and so better technical standard will definitely outweigh the benefit of a faster determination of the technical standards. The OPSG is also very concerned that EIOPA will not have enough time to read and assimilate all the responses to their proposal for the technical standards. The time period between the close of the consultation and EIOPA's report to the Commission is very short. Therefore, the OPSG strongly recommends that more time is allocated to this process.

<u>2) Valuation of HBS</u>

- The OPSG considers that the HBS may not be a useful instrument in assessing the solvency of the fund. If the pension contract is complete and all security mechanisms are included in the HBS, the funding ratio will always be 100%. This is because of changes in (market) conditions will have an impact on the value of the HBS items. Changes in markets, longevity etcetera will impact upon the balance sheet items (e.g. a decrease in assets will possibly lead to an increase in the value of the steering mechanisms and/or a decrease of the value of the adjustment mechanisms), causing the (holistic) funding ratio to stay unchanged. This will lead to a net solvency capital requirement of 0. In this sense, the HBS could be a very expensive exercise that only confirms when a pension contract is complete.

- It seems possible that IORPs will be able to complete the calculations required of the HBS. However, the OPSG has little confidence that the outcome will be useful for supervisors and the pension sector. To calculate the HBS, IORPs have to make many assumptions, so the risk of pseudo security is severe and the model-risk of this approach is very large. Markets are incomplete (e.g. long maturities, wage inflation, long term volatility) and thus dependent on modelling assumptions, so the reliability of outcomes is questionable. Altogether, this makes it very hard to compare the HBSs of different IORPs. If the HBS is to be used as supervisory tool, then there needs to be discussion between IORPs and supervisors to close-off the subjective assumptions that currently lie within the specification.
- The valuation of the different steering and adjustment mechanisms is also dependent on the prudential framework. What will be the length of recovery plans? How will the supervisor use tiering? These factors are unknown.
- On the one hand, inflation risk is not adequately taken into account. This risk could be material for final salary and revalued career average IORPs, or those which promise targeted inflation linked benefits. On the other hand, some SCR risks, copied from Solvency II, are over-emphasised or are not material to IORPs (see response to question 17).
- It is not clear how EIOPA will infer other security levels from the calculations on a 99.5% level. Due to the (option) valuations of the different steering and adjustment mechanisms, other security levels cannot be derived from the 99.5% level (since they do not conform to a normal distribution – these distributions are skewed and fat tailed).
- The underlying principles of the HBS are based on highly price efficient markets, normal distribution curves and stable correlations. The events of the last few years have shaken confidence in these assumptions. Indeed these model risks are not new; unfortunately they did not receive adequate consideration when Value at Risk (VaR) became a prudential tool for the banking and insurance sectors. Consequently we have concerns about the wisdom of using VaR as a supervisory tool for the pensions sector.
- We question the appropriateness of the HBS approach. The approach, founded on Solvency II, relies heavily on risk-free interest rates for the calculation of pension liabilities. Given the historically low level of interest rates and strong intervention in the credit markets by Central Banks, are we honestly in a period of 'genuine' risk-free interest rates for the purpose of calculating pension liabilities?
- Further, more time would be desirable in order to value the different steering and adjustment mechanisms. The implementation of a more simplified model that ensures a working/functioning risk-based supervisory-system will be key to the success of the revised Directive. The supervisory-system needs to cope with a financial crisis or it will become an instrument of pro-cyclicality.
- Alternatives to a HBS approach, like an ALM analysis or stress-test, should be studied. This does not mean that it may not be helpful to adopt a holistic framework which takes into account the different risk mitigating instruments. This holistic framework can contribute in an overview of the different steering and adjustment mechanisms. However, the OPSG have serious doubts as to whether the HBS is an appropriate supervisory tool.
- Lastly, the calculations of the different risks for the SCR frequently depend on the credit rating of the sponsor and investments. This is remarkable given that the Commission and the European Parliament are aiming to reduce reliance on credit ratings as a tool of risk management. According to a recent ECON statement, "*no EU law will be permitted to refer to credit rating for regulatory purposes"*.

3) Proportionality

- The costs of doing a QIS are a point of concern for many IORPs. Costs will run into tens of thousands of euro's or even more if an IORP still has to set up a new model in order to value the adjustment and steering mechanisms. These costs are not justified given the expected reliability of the outputs.
- The resources needed to run a QIS style solvency process will be very expensive to the majority of IORPs (this will be the same for the HBS itself if it is to become the future prudential framework of a new IORP Directive). Therefore, those that participate will be a biased sample of large pension plans, i.e. those with a greater ability to absorb the costs.
- The requirements for the application of proportionality are complex. The proposed process on when to apply proportionality seems to be more labour-intensive than doing the actual calculations. Hence the scope for applying proportionality seems limited.
- The possible impact of future costs on IORPs or the sponsoring companies with regard to the new framework are not addressed. As a large proportion of IORPs are small and provided on a voluntary basis, increased regulatory costs will inevitably cut member benefits.

The OPSG would like to point out that the Stakeholders – including the OPSG - cannot deliver thorough and comprehensive input to this consultation due to the inadequate time scale. As a consequence, this has limited the level of detail that we could offer in our response.

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Specific replies to EIOPA Questions to Stakeholders:

With regard to the specific questions raised by EIOPA in its Questions to Stakeholders, specific replies are set in the Annex below (EIOPA Template for Comments and resolutions CP003/2012) and are accompanied by supporting explanatory text.

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Adopted by the EIOPA Occupational Pensions Stakeholder Group via written procedure closed on 19 July 2012,

The Chairperson of the EIOPA Occupational Pensions Stakeholder Group

Chris VERHAEGEN

EIOPA-OPSG-12-08

	Comments Template on **CP-12-003 – Draft Technical Specifications QIS IORP II**	**Deadline** **31 July 2012** **18:00 CET**
Name of Company:	**Occupational Pensions Stakeholder Group of EIOPA**	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment in the relevant row. If you have no comment on a paragraph or a cell, keep the row empty. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-12-003@eiopa.europa.eu. Our IT tool does not allow processing of any other formats.** The numbering of the paragraphs refers to Consultation Paper 12-003.	
Reference	**Comment**	
General Comment	Please see General Observations above	
Q1.	No, the OPSG does not agree with the general set-up of the QIS exercise. This because of the following three reasons: 1) The QIS will not give all necessary insights for IORP II. 2) The representativeness of the QIS is insufficient for an IORP II proposal by the EC.	

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	3) This exercise is very exhaustive. 4) This QIS does not empathise with the "real life" of IORPs used as HR vehicles. <u>1) The QIS will not give all necessary insights for IORP II</u> • If this is the only QIS (on Lamfalussy Level 1) before the proposal of IORP II by the European Commission (as indicated by the European Commission), then not all relevant questions can be directed and clearly answered in one pass. To adequately capture the occupational pensions sector, EIOPA needs to request more information, on what is already a very complex QIS. Furthermore, insights from the Netherlands, where market consistent valuation is in use, suggest that the scope for subjectivity could lead to different interpretations by organisations, leading to different inputs, that are all market consistent. Numbers from the QIS are thus insecure and (very) dependent on assumptions (in calibrating the model etc.). • There is the risk that IORPs will not have enough time to be – and certainly are at the moment not – sufficiently equipped to reply (leading to a limited number of replies). Focus of responses will be on the technical details and not on general concept and usability of HBS. • The resources needed to run a QIS style solvency process will be very expensive to the majority of IORPs (proportionality). Therefore, those that participate will be a biased sample of large pension plans – those that can more readily absorb the cost. • In the UK, pension plans only approach this level of analysis in their triennial reviews. Again running this (HBS) exercise on an annual or even quarterly basis will be very costly. <u>2) The representativeness of the QIS is insufficient for an IORP II proposal by the EC</u>	

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	• Only 8 out of 27 Member States will participate in the QIS. • Municipal/Local Authorities pension schemes are not included, although these are significant providers of second pillar pension schemes. • In some Member States the QIS will not be performed by IORPs, but by supervisory authorities using aggregate data (or done by actuarial firms on behalf of the supervisory authority). It is our opinion that EIOPA and the Commission will only receive a good indication of the real impact of the QIS on IORPs, when the QIS is performed by IORPs. The use of aggregated data makes the comparison between funds and countries meaningless. EIOPA will find it very difficult to gain an adequate overview of this project without being aware of the moving parts that lie beneath the data. • If IORPs are unable participate in the QIS, they will not be able to respond (properly) to the qualitative questionnaire. It is the purpose of the qualitative questionnaire to obtain an assessment by the IORPs of the clarity of the technical specifications, the quality of inputs and results, the methodology of the QIS, the practicability of the calculations involved and the use of simplifications. In addition, IORPs will be invited to give a first impression of the outcomes of the QIS and the potential policy reaction by the IORPs and other stakeholders. How can IORPs respond to these questions if they are excluded from running the QIS? 3) This exercise is very exhaustive • The exercise is dependent on many – debatable – assumptions like stable correlations, normal curves, absence of tail-risk and the ability for analysts to accurately predict the future. • The events of the last few years have shaken confidence in the underlying assumptions of the HBS. Indeed these model risks are not new; unfortunately they did not receive adequate consideration when Value at Risk (VaR) became a prudential tool for the banking and	

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	insurance sectors. Consequently we have concerns about the wisdom of using VaR as a supervisory tool for the pensions sector. 4) This QIS does not empathise with the "real life" of IORPs used as HR vehicles. The proposed technical specifications are heavily inspired by the Solvency II framework for insurance companies. The level of detail and complexity of the QIS is beyond the capabilities of most sponsoring companies and their IORPs. These IORPs will have difficulty in completing the questions and will be limited in their ability to comment properly. If this QIS concept becomes the blueprint for a new supervisory regime for IORPs, then there is a significant risk that it will undermine the future motivation of sponsoring employers in the Member States to evaluate, to set up and to use IORPs in future. **Improvement of the QIS** The OPSG recommends more QISs and greater IORP representation across Europe, before the European Commission makes its Level 1 proposal. More QISs will lead to higher stakeholder involvement and a better understanding by IORPs, Commission, Parliament and supervisors on how to shape the revised IORP Directive. In addition, more information with respect to the characteristics of the technical provisions and the prudential framework will be necessary, for example the tiering of assets and liabilities and recovery periods. Some supplementary questions which EIOPA could ask are: • What does a healthy pension fund look like? This is a three dimensional issue that includes assets, liabilities, sponsor /IORP health and the	

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	scheme's age profile. • What percentage of all technical provisions are due in the next ten years? This should sub-divide the best estimate of liabilities between those falling between now and ten years and those due in more than 10 years – it provides some insight into the maturity profile. • What suggestions do stakeholders have to link supervisory actions with (changes in) the characteristics of the HBS? When and how should these be triggered? • What views do stakeholders have on the length of recovery periods?	
Q2.	No, the OPSG does not think that the adjustment (discretionary and conditional benefits, last resort benefit reductions) and security mechanisms (sponsor support, pension protection schemes) are taken into account adequately. If there will be only one QIS, this QIS should provide all the possible answers, insights, and numbers. This is not possible under the current technical specifications. These answers, insights and data need to be addressed, since the adjustment and steering mechanisms are new elements (compared to other topics) for EIOPA to assess and it is unlikely that we can fully assess them correctly in one QIS. The adjustment and steering mechanisms define the difference between pension funds and insurance companies, making the HBS even more complex than Solvency II. After 5 QISs the Solvency II framework is still unclear, with the discount curve (UFR, matching premium/counter cyclical premium) still undecided with the impact of the curve on the solvency position of insurance companies (and also on the markets and the economy) being extremely severe. The Commission and EIOPA will not be able to calibrate the adjustment and steering mechanisms for IORPs in one QIS.	
Q3.	The "old-items" – which are directly copied from Solvency II – are sufficiently clear and well documented. The "new-items" – such as the	

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	valuation of the steering and adjustment mechanisms – are understudied and insufficiently clear, more guidance is necessary. Here are some examples: • The HBS requires complex (option) techniques. There is little attention to these techniques in the technical specifications. • The relation between the valuation of the different steering and adjustment mechanisms and prudential framework is important, but unknown (e.g. length of recovery plans, tiering). • The valuation of liabilities and contingent assets is dependent on many difficult assumptions. Note there is no market for long dated liabilities, for wage indexation and long term volatility (important for contingent assets and liabilities like sponsor support and conditional indexation). • It is unclear how incomplete pension contracts/discretionary benefits should be valued. • How many years of use of steering instruments may be included? The more years of extra contributions, the lower the capital requirement. • The OPSG supports the proposal that the specific characteristics of IORPs, like sponsor support and pension protection schemes, are taken into account. However, the methodology to take sponsor (employer) support and pension protection schemes into account is of an incredible complexity and gives significant rise to doubts whether this issue and its nature (even from a SLL perspective) is really understood. Given the fact that the valuation of sponsor support and pension protection schemes are new concepts, then the need for a profound discussion on these topics is manifest. Stakeholders should have the opportunity to respond not only to the technical standards, but also on the draft QIS spread sheet before the QIS performed. It is unclear if the reporting template will be set up in such a way, that it will also be useful for auditors. It would have been easier for	

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	stakeholders to respond to this consultation, if a draft spread sheet for the QIS was already attached to the consultation document.	
Q4.	The calculations proposed in the technical specifications are feasible, but the accuracy and the sensitivity of the outcomes are questionable. To calculate the HBS, IORPs have to make many assumptions, so there is a severe risk of pseudo security. Balance sheet items will receive a value, but this value is very sensitive to many underlying assumptions, which in changing them, could lead to completely different, but legitimate, results. The "model-risk" of this approach is very large. There will be an accumulation of assumptions and therefore insecurities. The impact of a small change in the assumptions can have a large impact on the outcome, because the sensitivity to some assumptions is high. Therefore, the OPSG has little confidence that the outcome will be useful for supervisors and the pension sector. The costs are probably not justified given the expected reliability of the outcomes. The process is very expensive (it implies doing an ALM type of study). Costs will run into tens of thousands of euros and even more if an IORP still has to set up a new model in order to value the adjustment and steering mechanisms. In order to mitigate the costs of performing a QIS, the OPSG would suggest that the analysis is conducted using December 2012 data, as it gives IOPRs an opportunity to bring forward reviews and make more cost efficient use of the actuarial resources.	
Q5.	Yes, the OPSG believes that the draft technical specifications provide enough guidance on how to set up and value the HBS. However, there is too little guidance provided on how to calculate the desired value of the adjustments. This requires a lot of interpretation in order to evaluate the steering and adjustments mechanisms. This will lead to large differences in the answers; both from interpreting how and which options should be taken into account,	

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	as from the way these options should be calculated. Further, there is too little attention in the draft technical specifications for the interaction/co-integration between the various steering/adjustment instruments. The value of the different elements out of the HBS cannot always be aggregated. For example, an increase in the value of the sponsor's support will also influence the value of conditional benefits in the concept of a HBS. In order to have a good insight on the actual impact of the QIS exercise, EIOPA should ask for the numbers AND the underlying assumptions from each scheme. The OPSG realises that this more comprehensive analysis makes the QIS more burdensome. Therefore, the OPSG asks whether EIOPA has considered the amount of resources that would be required to supervise this prudential structure. If the HBS were to be implemented as supervisory instrument, who is going to pay for the additional resources to supervise this regime?	
Q6.	In general, hard evidence based justification is required to use simplified calculations. The proposed process on when to apply proportionality seems to be more labour-intensive than doing actual calculations and this implies that IORPs might not use the simplified calculations. According to the OPSG, many more simplifications are desirable (given the purpose of this QIS). Starting simple and gradually deciding on where more sophistication is needed – to form the basis of the next QIS – is a better process and would lead to a better outcome. The valuation of the sponsor support and the pension protection scheme could be simplified further. The use of ratings to evaluate sponsor support can create an excessive burden on sponsors, namely on small and medium companies, not-for-profit and public companies since these companies do not have ratings. The same problem arises for multi-employer IORPs. The simplification for the valuation of amounts recoverable from insurance and	

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	the risk margin is adequate. However, the OPSG rejects the proposal of an inclusion of implicit or explicit risk margin or buffer as part of technical provisions. The concept of cost of capital is not relevant for IORPs. In addition, no attention is paid to the fact that the value of the risk margin will interfere with other elements of the HBS – this needs to be clarified.	
Q7.	The OPSG believes that IORPs will be able to take into account the trend in mortality rates, at least from a technical point of view. The providers of mortality tables need to be reputable. In this context, mortality rate-trends should be defined on a national level, for example by national working groups, and not on a harmonised European stage, so that structural disparities can be dealt with appropriately. Currently, not all Member States use the 'foreseeable trend' in their calculations. This highlights differences in the application of pension regulation between Member States. Moreover, IORPs in those Member States where at this time there is no obligation to use future mortality rates in the calculation of technical provisions, will be confronted with significant immediate increases in their provisions.	
Q8.	No, it is not clear enough from the technical specifications what cash flows should be taken into account in the calculation of the best estimate. There is a clear case for more guidance, to assure some utility and comparability of the outputs. For example, more guidance is required for: • When projected benefit obligations (PBO) i.e. allowing for future salary increases should be taken into account. • Definitions of conditional, discretionary and mixed benefits are not clear and it is therefore very hard to make a distinction between those. • Difference between "ex post" and "ex ante" benefit reductions. • Definition and use of conditional benefits and contractual options.	
Q9.	According to the OPSG, the possibility to reduce benefits in the valuation of the best estimate of technical provisions should be taken into account, under	

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	the condition that benefit steering is a regular steering instrument, which has been properly communicated to the members. If benefit steering is only an "ex-post" steering instrument and has not been properly communicated to the members the possibility to reduce benefits should not be taken into account. However, the OPSG wants to point out that this question is intertwined with social and labour law. In some Member States, pension reduction or benefit steering is a clear part of social and labour law; in others sponsoring companies are always required to guarantee the pension promised.	
Q10.	This question highlights the different sponsor relationships between Member States. It implies that these technical specifications could be possible in one Member State, but not in the other. The OPSG have some serious concerns (see also Q3) with the principles for the valuation of sponsor support: • Employing sophisticated modelling techniques that forecast the sponsor's financial capacity depend on mean (Central Limit Theorem) forward assumptions behaviour. • In reality the outcome will be bifurcated, i.e. the sponsor can either cover or not cover the deficit. In some Member States the sponsoring company has to cover the deficit anyhow. Unless the sponsor is bankrupt the sponsor cannot escape from this legal obligation. • This legal obligation demonstrates why the Holistic Balance Sheet approach on the level of the IORP does not always make sense, for example, where an IORP has two different pension schemes with two different sponsoring undertakings. Some of the questions of the QIS lead to the valuation of the sponsoring company, but how do you value the sponsor covenant, where there is more than one sponsor (e.g. industry-wide pension schemes) or how do you value the sponsor support for a	

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	public pension scheme? An approach linked to the schemes irrespective of the pension provider could make more sense. Otherwise – from the perspective of some different Member States – some schemes and thus members are treated differently than others. Therefore, the question arises if the HBS approach should be used for supervision of IORPs or of pension schemes. More guidance with respect to this question would be desirable. • Though far from perfect (due to bifurcation) an assessment of the sponsor covenant could be based on the present value of the deficit and the capability of the sponsor to cover the deficit today – through the issuance of a bond. • Alternatively if the sponsor is a public and listed company with credit default swaps. The pension fund liability and the ability to fund the liability will manifest itself in the pricing of the sponsor/issuer's CDS. According to the OPSG Pension Protection Schemes (PPSs) should be incorporated as an asset on the HBS. We endorse the notion of HBS 6.71, if the PPS covers 100% of the benefits and is sufficiently strong, its value should close the funding gap. This would be a simplification for the IORPs and would avoid unnecessarily complex HBS accounting. Alternatives for the proposed valuation and the HBS are Asset Liability Management (ALM) studies, scenario analysis and/or stress testing. These are simpler methods than those of the HBS, because the HBS implies probability weighted mark-to-market valuation, which requires ALM scenarios including discount factors (like risk neutral valuation or deflators). These kinds of alternatives should be studied before a new IORP Directive will be proposed. Also, additional fundamental studies are needed to consider how sponsor (employer) support and PPS, being SSL issues at their core and offering high level protection, affect supervisory structures.	

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Q11.	In general, a simplification would be better than the complicated mathematical calculations (for the first QIS). The OPSG wants to highlight that it would be difficult to provide any meaningful parameters on the probability of default and recovery rates, using financial models with extensive time horizons. Little comfort can be achieved through an average expectation, because the situation will vary considerably from sponsor to sponsor. (A lot of this stochastic work depends on stable correlations and high coefficients of determination (R^2s) – which are not present in the real world). Another point, which needs clarification, is where do the IORP claims rank with other creditors in the case of a sponsor's default? Is this ranking consistent across Member States? Also see also Q3. The OPSG does not advocate short recovery plans, however the OPSG believes the acid test is whether a sponsor if called upon 'today' can finance an IORP deficit. With a positive answer a recovery plan (and its duration) is the product of negotiation between the IORP and the sponsor. If the answer is negative, then this becomes a supervisory issue and a point where the PPS may have to support the scheme (for example in the UK model).	
Q12.	No, the OPSG does not agree with the methodology that sets out the maximum value of sponsor support (see also Q3). As already mentioned in question 11, the methodology's assumptions for the prediction of cash flows, default probabilities and recovery rates, are at best educated guesses. Another issue will be to decide how many years of EBTDA to include; the more years the better the funding position of the IORP. Conversely, using EBTDA as a proxy for free cash could either put the sponsor into insolvency (as it leaves no cash to run a viable business) or create a false image of	

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	security. A possible simpler alternative could be to take the last 5 or 10 years average ROE (Return on Equity) (a 'very rough' proxy for distributive cash) multiplied by the current equity to give today's capacity, then add a growth factor typical of the economy (2.5%) and discounted by the implied default rate (see page 34 credit ratings) sum the values over time to the value required to fill the deficit. If the time required exceeds 'x' number of years e.g. 10, then the quality of the sponsor's covenant is questionable and requires supervisory scrutiny.	
Q13.	The OPSG agrees with the proposals of performing an upward shift in the basic risk-free interest rate curve to approximate the so-called counter cyclical premium and to allow IORPs – under conditions – to apply the so-called matching premium in order to take into account the long-term nature of pension liabilities. Referring to the counter cyclical premium (HBS 8.12), the OPSG would like to mention that this adjustment could be helpful, but in the current market environment (distorted by government intervention) a 50bp upward adjustment in the risk-free yield curve does not do justice to historical observations. In addition, more information will be necessary with respect to the conditions for when the counter cyclical premium can be used. With respect to the matching premium (HBS.8.13), the OPSG welcomes the QISs recognition that near and medium term duration technical provisions will often be hedged by IORPs as the market for risk-free (government) hedging 'short and medium term' instruments is deep. It is still unclear in the technical specifications how the adjustment of the risk-free interest rate curve (Ultimate Forward Rate, counter cyclical	

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	premium) will interfere with the (option) valuation of the steering and adjustment mechanisms. For this valuation, normally a non-adjusted risk-free interest rate curve is used (risk neutral valuation). More explanation in the technical specifications will be necessary in order to prescribe a consistent valuation approach in the HBS, as currently this is not possible.	
Q14.	The OPSG strongly welcomes the proposal that there will also be a "Level B" discount rate in the QIS, based on expected returns of the strategic asset allocation rather than a risk-free discount rate, but it is questionable if the level B discount rate should be derived from bond rates at current levels. A better approximation for the bond yield could be derived from the long-term historical average of the strategic bond mix described in HBS 8.17 (page 58). An alternative to discounting non-fixed income assets might be to build a model on the sum of historic real economic growth rates (g), historic rates of inflation (f) and historical non-fixed income yields (y) – dividends etc. If g= 2.5%, f = 2.5%, y = 3%, then the product is 8%. This might be a more realistic expectation for the long-term return on non-fixed income assets. *Of course both long-term averages and the factor model imply that bond yields will rise, creating losses on the fixed income component of portfolios and liability hedges.* Furthermore, the fixed risk premium of 3% for all other kind of assets does not correspond with the different level of riskiness of these assets (as prescribed in the SCR standard formula). So, there will be an imbalance in risk-return trade-off creating distortions, such as a strong incentive to invest in property (same expected return, but lower capital requirements than equity).	
Q15.	The OPSG does not agree with the draft technical specifications for expected annual inflation and salary growth, currently set respectively at 2% and 3%. It is quite remarkable that the core principle of market valuation is not used	

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	for one of the most important risks for a pension fund. The OPSG suggests applying break-even inflation assumptions implied by financial markets. These will lead to valuations consistent with financial markets – using 2% and 3% will not. If and when financial markets discount for rising inflation (they will be more responsive to actual events), these will be reflected in the HBS. Since there is no market for wage inflation, using break-even inflation for price inflation plus 1% could be suggested. A further study on the market impact of using break-even inflation assumptions will be required. In general, the OPSG would like to ask EIOPA to pay much more attention to inflation risk in the QIS given the importance of (wage) inflation for IORPs.	
Q16.	It seems as if a significant part of the calculation will be done by the spread sheet to be supplied by EIOPA, so that understanding all of the formulae may not be a requirement, as the correct answer should emerge if the right data is input. This implies that the QIS can be performed by IORPs. However, it is still very questionable if IORPs will understand what they will be doing and will have a reliable outcome to interpret. In some cases, simplifications are suggested and will probably be used where it seems reasonable to do so. For some Member States, certain elements will be irrelevant.	
Q17.	Before the question if stakeholders believe that the risks IORPs are facing are adequately reflected in the calculation of the SCR and MCR will be answered, the OPSG would like to mention that it is not clear how EIOPA will infer other security levels from the calculations on a 99.5% level. Due to the (option) valuations of the adjustment and steering mechanisms, other security levels can not be derived from the 99.5% level (since there is no longer a normal distribution). In addition, the calculation of the different	

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	risks for the SCR rely very much on the credit rating of a sponsor and investments. This is remarkable since the Commission and MEP's are aiming to reduce over reliance on ratings. According to a recent ECON statement, *no EU law will be permitted to refer to credit rating for regulatory purposes*. The objective for a MCR within a prudential framework for IORPs is unclear. Therefore, it is not possible to respond to the question if the risks IORPs are facing adequately reflected in the calculation of the MCR. **SCR Risks** The OPSG believes that – especially for the purpose of this QIS – some risks should not be included in the calculation of the SCR as they are not likely to be material: • Health risk (in most Member States) • Operational risk • Intangible asset risk module • Market concentrations risk • Pension disability-morbidity risk • Pension revision risk • Pension catastrophe risk sub-module • Counterparty default risk module - except for sponsor support <u>Market risk:</u> • The OPSG would like to draw attention to the fact that the capital requirements for equity as proposed will provide a strong incentive for pension funds to change their asset mix into more bonds, which increases risk to inflation <u>Pension longevity risk:</u> • There is an element of double or even triple counting in the requirement to assume a 20% decrease in mortality rates as the best estimate used	

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	in calculation of the technical provisions already includes allows for future improvements in longevity and IORPs possibly have to use a risk margin in the valuation of their technical provisions to provide for uncertainty around the longevity trend included. <u>Pension disability-morbidity risk:</u> • The capital charge for pension disability-morbidity risk could be lower compared to insurers, since IORPs do not have the disadvantage of adverse selection (due to mandatory participation) **Additional risk categories** <u>Inflation risk:</u> • This could be material for final salary and revalued career average IORPs, or those which promise or target benefits increases which are inflation linked. <u>Regulatory risk:</u> • In practice, this has been a major risk for IORPs in some Member States, but it would not be acceptable to require IORPs to hold additional capital against the risk of future regulatory changes.	
Q18.	The way the loss-absorbing capacity of adjustment mechanisms and security mechanisms is not adequately taken into account in the calculation of the SCR. Specific details on how to calculate the net SCR parts are missing, especially the nBSCR(TP) and nBSCR(SM) and – the simplification of separating the effect of loss absorbing capacity of the technical provisions and of the steering mechanisms is inappropriate for most IORPs in which both depend on a funding ratio. Also, the separation is no simplification as it requires double the calculations and an unclear treatment of interdependent effects.	

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	In addition, the sequence of calculation is extremely difficult to follow. We propose a method in which not an adjustment (Adj) for the loss absorbing capacity is calculated, but rather a direct calculation of a gross and a net SCR. The detour of any adjustment calculation is considered unnecessary and complex for the purpose of this QIS. The OPSG would like to note that under full loss absorbing capacity in case of a complete contract, the change in the funding ratio of the HBS will be always 0, and therefore results in an SCR of 0.	
Q19.	The OPSG thinks that operational risk can be ignored in a first QIS or otherwise could be a fixed number (as a simplification). Next to that, the OPSG would expect that the operational risk of IORPs should be at a lower level than for insurance companies (and therefore lower than the proposed parameter in the consultation document), since IORPs are not-for-profit organisations and therefore do not have the operational risks of a profit-seeking strategy. In addition, the cost of operational failure may be met by third parties e.g. the sponsor or outsourced service provider meaning that the IORP would not suffer any financial impact from the operational failure.	
Q20.	First of all, the OPSG believes that some of the basic calculations are too complex, given the expected materiality of the risk and the purpose of this QIS. Start simple and possible sophistication in later stages will result in a better outcome. As discussed earlier, certain risk categories are not relevant for IORPs (such as catastrophe risk) and should at the least be excluded from this first QIS. From a technical point of view, the simplifications provided for the calculation of the SCR appear to be adequate but this can only be ascertained by practical testing.	

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Q21.	The OPSG considers that the treatment of sponsor default risk should be a separate module and not be incorporated in the counterparty default risk module of the SCR calculation. This because of the importance of sponsor support in the HBS. The counterparty default risk module of the SCR calculation is very detailed and may not be that material (except for sponsor support). This is assessed by assuming 50% loss given default where probability of default is based on credit rating of sponsor e.g. 0.002% for AAA. The OPSG would recommend that an explanation for this approach is given to enable stakeholders to comment, and if appropriate to suggest alternatives.	
Q22.	The benefit option risk is not relevant for all the Member States. The OPSG understands that this module is intended to assess the capital required where members of the IORP can select options which could increase the level of technical provisions required. This includes early or late retirement, commuting pension for cash or transferring out a cash sum to another IORP or insurance policy on leaving the employment to which the IORP relates. These options would normally be exercised on terms which are fixed in advance or terms decided at the time. It is appropriate to require solvency capital in the first instance if the fixed terms would cause a strain, as the technical provisions would increase if the number exercising the option exceeds the best estimate built into the cash flows, or a surplus, in which case the technical provisions would increase if the number exercising the option is lower than the best estimate. The OPSG presumes that the SCR is to be determined in the same way as for insurance company lapses which we consider may not be appropriate. In the second case, the terms would normally be determined with a view to ensuring that the IORP did not suffer a strain (or the member gain a benefit) by exercising the option. In this case, it would seem unnecessary to require any SCR for	

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	this risk.	
Q23.	The descriptions of financial and insurance risk mitigation are not sufficiently clear and understandable for IORPs. For smaller IORPs these items will be not relevant.	