

Comments Template on CP-12-003 – Draft Technical Specifications QIS IORP II		Deadline 31 July 2012 18:00 CET
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<b>Reference</b>	<b>Comment</b>	
General Comment	The European Association of Public Sector Pension Institutions (EAPSPI), which covers 26 pension institutions and associations of the public sector out of 16 European countries and speaks for 33 million people throughout Europe, would like to make the following general remarks ahead of the answers in detail:	

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EAPSPI fully agrees with the aim of the Commission in the Call for Advice of April 2011, according to which **a risk-based supervisory system for IORPs should be developed on the basis of the IORP Directive as the starting point**. This approach is justified due to the basic differences between IORPs and insurance undertakings, as EIOPA itself has identified several times (i.e. in the previous second consultation document on the review of the IORP Directive, EIOPA-CP-11/006, in particular see 9.3.6 a – h). EAPSPI has reservations that in spite of this commitment, this consultation on the technical specifications – as well as the previous consultation on the IORP review – is built on the Solvency II principles and structure.

EAPSPI continues to be of the opinion that the supervision of IORPs requires a **regulatory regime sui generis** that truly accounts for the differences of IORPs and insurance companies. Due to the differences of pension schemes all over the EU, EAPSPI suggests to respect those differences among occupational pension systems in the different member states when designing a new regulatory framework.

Bearing in mind the details of the HBS concept laid out in the technical specifications draft for the QIS, EAPSPI is of the opinion that the **purpose of the HBS** and EIOPA's conclusion in case of a deep impact on IORPs and occupational pensions the study on capital requirements is not clear:

- Does the HBS “only” have an **informational character** in order to foster transparency, measuring and comparability of security mechanism of IORPs, as was mentioned several times in EIOPA's recent consultation document from October 2011 and EIOPA's advice to the Commission in February 2012?

**or**

- Is the HBS meant to be a **supervisory tool** – this was also mentioned by EIOPA – supposed to **automatically trigger consequences** in terms of higher solvency capital charges for IORPs and supervisory actions?

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Given this uncertainty, EAPSPI would like to emphasise that commenting on the HBS is difficult.

EAPSPI therefore expresses its **general concern with the HBS** as presented in the draft for the technical specifications. As the QIS consultation does not offer the possibility to address this issue and to question the character of the consultation (see on this EAPSPI's answer to Q1), EAPSPI sketches its general reservations about applying the Solvency II principles and the SCR structure to IORPs. It would not be possible to answer EIOPA's question on the QIS without being able to refer to this argumentation.

- The **Solvency II** regime is **not necessary for IORPs**. The already existing security mechanisms have proven to be safe during the past crisis.
- IORPs have specific **inbuilt security mechanisms** that ensure the solvency position of pension schemes. In some pension schemes, contributions and the main benefit parameters can be modified by the employers and the employees' representatives.
- Many pension schemes, especially of the public sector in the Netherlands, Scandinavian countries or in Germany, foresee **paritarian management**. Paritarian management involves social partners on the Board of Directors of the IORP or in similar internal supervisory bodies. Due to paritarian representation, the interests both of the employers and of the employees and beneficiaries are well-balanced and the benefit security can therefore be ensured.
- Due to the fact that IORPs in the public sector are **social institutions** and therefore not chiefly for profit organizations, the possibility of a potential conflict of interests between member protection and profit maximizing behavior and dividend payments is minimised.
- For DB- and hybrid DB-/DC-schemes, in at least some Member States, **employers have the ultimate responsibility to fulfill the respective pension commitment**

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- **The structure of Solvency II is not appropriate** for the regulation of IORPs due to the differences between IORPs and insurance undertakings. Because of the long-term nature of pensions, the actual risks IORPs are facing differ from those of insurance undertakings. Indeed the stable and long-term character of IORPs' liabilities has various risk mitigating effects.  
The methods of measuring and quantifying financially the risks of IORPs as laid out in Solvency II do not meet the nature of IORPs. These aspects should be taken into consideration when redesigning the regulatory framework for IORPs (see in particular EAPSPI's answers to Q2, Q10 and Q17 on these aspects).
- The HBS and the calculation of the SCR in the draft specifications fully rest on the Solvency II structure of measuring and quantifying risks which EAPSPI regards as inadequate for IORPs. By maintaining this structure, the **HBS itself is not an appropriate approach for IORPs**. The fact that security mechanisms of IORPs are considered at a later stage may not solve this general problem (see EAPSPI's answer to Q2).
- Additionally, given the proposals of EIOPA in Section 2.6, EAPSPI is of the opinion that the **HBS is not appropriate** to reach the intended goal of the Commission namely **to precisely assess and quantify the "true risk position" of IORPs** (CfA 4.1), because of the design and the valuation of the HBS. The valuation still involves a high degree of arbitrariness and leads to pseudo-certainty which contradicts the notion of a neutral, objective and informative balance sheet. Also, the question arises how to evaluate the financial solidity of a public sector institution as employer and sponsor. Moreover, EIOPA introduces an additional channel for bringing more volatility into the balance sheets of IORPs (see EAPSPI's answer to Q10).

Furthermore, the HBS leaves room for what could be named the **"Holistic Balance Sheet Paradox"**: The security level for the employees is the same as without the HBS, economically speaking nothing changes, but - with the HBS - costs increase dramatically. The existing security

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	<p>mechanisms today already safeguard at a low cost exactly the same level of security which would be created with so called quantitative precision in the new regulatory regime for a much higher cost (best case) if not for the price of termination of existing pension scheme arrangements (worst case).</p> <p>As a conclusion, given the quality of the various existing security mechanisms of IORPs and the problems of a precise quantification and risk assessment for IORPs and their security mechanisms, EAPSPI argues for not implementing the HBS because the security mechanisms of IORPs as “holistic assets” deliver a flexible insolvency protection and make up for truly exceptional cases that should release IORPs from a Solvency II-like risk-based regulatory regime.</p> <p>Again, <b>EAPSPI regrets</b> the very <b>limited time frame</b> of this complex and important consultation. The consultation of the technical specifications for the first time offers stakeholders the possibility to study thoroughly the long debated HBS. Due to the short time frame, EAPSPI has decided to concentrate on only certain aspects of the consultation document.</p>	
Q1.	<p><b><i>Do stakeholders agree with the general set-up of the QIS exercise as put forward in the Introduction (Chapter 1)? What improvements do stakeholders suggest?</i></b></p> <p>EAPSPI welcomes the opportunity given by EIOPA to have access to more detailed information on the HBS, particularly EIOPA’s intention on how to cope with the valuation of security mechanisms. EAPSPI also welcomes the idea to assess the impact of the HBS on the financial requirements for IORPs.</p> <p>The general approach of the consultation on the technical specifications for the QIS is very technical by nature, strictly focusing on detailed quantitative aspects. Because of the necessary qualified staff and resources smaller IORPs will find it difficult to participate in the QIS. Regarding the content of the consultation, EAPSPI would like to express its concern that the setup of the consultation aims at one direction only, namely the Solvency II structure for IORPs: the structure</p>	

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	<p>of the technical specifications and the forthcoming QIS is identical to Solvency II, as EIOPA confirms (see I.4.5.). The only exclusion is the question of how to include security mechanisms of IORPs etc. as financial assets in the HBS. By answering detailed technical questions on how to apply the Solvency II structure, <b>stakeholders are forced to accept implicitly that Solvency II has become the blueprint for the IORP review</b>. This includes the general pillar I principles (market-consistency, risk-sensitivity) as well as the actual calculation of the SCR. With their 23 questions, EIOPA asks stakeholders to help finalise the technical design of a complex structure - without specifying how the structure will be used.</p> <p>As an improvement, EAPSPI would like to suggest to allow EIOPA more time to reconsider the general direction of the review of the IORP directive and to discuss openly how to regulate IORPs. EAPSPI would like to point out that <b>general and crucial topics on how to review the IORP directive are not settled</b> (see the general comment above). These topics were already part of EIOPA's Call for Advice on the review of Directive 2003/41/EC, EIOPA-CP-11/006, second consultation of 2 January 2012. The majority of stakeholders opposed the adoption of the Solvency II framework and principles (market-consistent valuation, risk-sensitive capital requirements) According to an analysis conducted by the German pension association aba, 108 out of 127 statements were against a Solvency II-like risk-based SCR, 15 of the 19 supporting statements came from the insurance sector. 48 out of 86 statements clearly were against a market consistent valuation of assets and liabilities, only 24 statements supported without restrictions a market consistent valuation. A similar situation could be found at the Public Hearing of the Commission on the Review of the IORP-Directive which took place on 1 March 2012: the majority of the stakeholders (i.e. employers' associations, trade unions, industry federations) opposed an adoption of a Solvency II-like regulatory regime. Also, the political representatives of the UK, the Netherlands, Germany and Ireland demonstrated a truly "united" opposition to Solvency II for IORPs (all mentioning their surprise at the high degree of social consensus with regard to the topic in their countries). These concerns seem to have gone unheard since the QIS will be carried out on a Solvency II basis as regards structure and principles. It seems important to pay attention to these voices and to find answers to the open questions which should be based on a mutual interest of adequate, safe and sustainable pensions in Europe.</p>	

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	<p>Concerning the SCR, EAPSPI would like to point out that differences between Solvency II and the current suggestion are marginal. The idea of a regulatory framework <i>sui generis</i> for IORPs seems to have vanished. IORPs will have to calculate <b>pure Solvency II numbers</b> the only differences being some adapted risk categories and the same parameterisation of the remaining categories (see the explanations on the gross SCR calculation in SCR.2.8.ff and on the risk-categories in Section 3). Only as a second step will the loss-absorbing capacity of security mechanisms and technical provisions of IORPs be accounted for – on top of an inadequate structure to measure the risks of IORPs. In addition, IORPs shall also calculate as an option the basic risk-free interest rate according to the QIS5 extrapolation method (HBS.8.11.). EIOPA points out (SCR.2.9.) that the gross SCR <i>“is an additional source of information about the risk profile of the IORP.”</i> But this <i>“additional information”</i> is exactly the Solvency II perspective. In the end, a comparison of the results of QIS 5 for insurance companies and the IORP QIS is possible, only adjustment for the differing interest rate levels has to be made.</p>	
Q2.	<p><b><i>Do stakeholders believe that the adjustment (discretionary and conditional benefits, last resort benefit reductions) and security mechanisms (sponsor support, pension protection schemes) IORPs dispose of are taken into account adequately?</i></b></p> <p>EAPSPI is of the opinion that the security mechanisms (sponsor support, pension protection schemes) IORPs dispose of are not adequately taken into account in the HBS.</p> <p>The general concerns that both the differences of IORPs and insurance undertakings, especially the existing security mechanisms and that the method of risk and financial assessment are inadequate for IORPs materialise in the concept of the HBS.</p> <p><b>The HBS conceptualizes the specific characteristics of IORPs only as additional financial assets.</b> This perspective generally equates IORPs with insurance undertakings, respecting differences only as new assets put on top of the same basic structure. However, this perspective neglects the <b>structural differences of IORPs and insurance undertakings</b> due to the fact that in the case of occupational pensions there is a <b>3-party relationship</b> (employer, employee and IORP). This</p>	

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	<p>accounts particularly for the public sector where the sponsoring employers generally show a very reliable financial stability. In addition, the institutional characteristics of certain IORPs especially in the public sector (<b>not-for-profit, balanced or even paritarian governance and decision-making</b> etc.) play a crucial role. This provides for a very flexible and efficient structure for securing employees' rights.</p> <p>The structural difference changes the starting point for regulating IORPs: The idea of the "back up facility" sponsor support and pension protection scheme is that they step in when they are needed no matter if the development is "normal" (HBS) or "stressed" (SCR). The structure of the QIS leads to a differentiation of the value of the security mechanisms in the HBS ('normal development') and their loss-absorbing capacity in the SCR ('stressed development'). Dividing the security mechanisms in this way leads to unnecessary and superfluous complexity.</p> <p>This flexible organisational feature of occupational pensions is also implicit in the proposals of the technical specifications when the value and the loss-absorbing capacity of IORPs' security mechanisms are discussed (chapter 2.6 and 3.2). For example, the IORP <b>can activate a proportion of current and future profits of the sponsor as an asset</b> in its HBS even in <i>normal times</i> (HBS.6.29 and 6.30) and additionally the sponsor support has a flexible loss-absorbing capacity, as <i>"the actual value of the sponsor support in adverse scenarios can exceed the average value"</i> (HBS.6.55). The added value of the HBS could be seen as the attempt to examine quantitatively the sponsor's ability to deliver these flexible payments when necessary (see HBS.6.26). The question remains if the actual method to assess the future economic position and earning power of a company is reliable. Also, the assessment of the future economic position of public sector entities as sponsors of IORPs poses further questions not tackled in the QIS. Serious doubts are indicated concerning the involved fundamental uncertainty of future payments (see also EAPSP's answer to Q10).</p> <p>This aspect can be seen even more clearly with respect to <b>pension protection schemes</b>, when EIOPA states that in general the value of the pension protection scheme in the HBS shall set as the coverage rate times the Level-A technical provisions (HBS.6.70) which implies for a pension</p>	



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	<p>protection scheme with a 100%-coverage rate that <i>“its value is equal to the funding gap that would appear in the holistic balance sheet (including sponsor support as an asset) without the pension protection scheme. In other words, in this case the value of the pension protection scheme closes the gap.”</i> (HBS.6.71) In consequence this also implies that the loss-absorbing capacity of a <i>“sufficiently strong”</i> pension protection scheme with a 100% coverage rate <b><i>“can be seen as a risk mitigation mechanism with full loss absorbency to reduce the SCR to zero.”</i></b> (HBS.6.87). EAPSPI fully agrees with this since this is in fact exactly the consequence of the quality and flexibility of the already existing security mechanisms.</p> <p>As a consequence, the question about the added-value of the HBS arises. EAPSPI fully agrees that a thorough examination of existing security mechanisms is important. However, the <b>implementation of the HBS involves difficulty</b> in terms of effort and cost to comply with all requirements and calculations <b>to justify the limited expected gain of insight</b>. A certain arbitrariness and the uncertainty of a precise valuation of existing security mechanisms contradict the notion of a neutral, objective and informative examination (see EAPSPI’s answer to Q10 for more details).</p> <p>As a result, the impact of the consultation and the QIS could be twofold:</p> <ul style="list-style-type: none"> <li>• either the <i>“Holistic Balance Sheet Paradox”</i> (see general comment): The examination confirms that the existing security level and its loss-absorbing capacity for the protection of employees is sufficient, so no increases in capital requirements result and economically speaking nothing changes, but with the HBS effort and cost have increased to come to this conclusion and to safeguard this level of security, or</li> <li>• the examination suggests a significant increase in SCR, which poses a big problem for IORPs and the sponsoring undertaking to get the necessary capital. And the result is what might be called the <i>“Solvency II Paradox”</i>: IORPs are permanently secured against risks that are supposed to nearly never materialize. Thus benefit reductions today and in the future are necessary to secure against highly unlikely future events.</li> </ul> <p>Taking all these aspects into account, <b>EAPSPI offers a different conclusion</b> than the one drawn in</p>	

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	the QIS draft. The existing security mechanisms, for instance of public sector IORPs, are sufficient. There is no need for a questionable quantification and to reduce them to solely financial assets in the Solvency II structure because of the flexibility and quality of those mechanisms: <b>The existing security mechanisms of IORPs should not be seen as a part of the solvency capital to fulfill the SCR within the Solvency II structure – they have a <i>substitutional character</i> and should therefore replace the SCR and free IORPs from a Solvency II oriented risk-based regulation</b> - in EIOPA's words (I.4.9): <i>"Adjustment and security mechanisms will lower the SCR by absorbing losses incurred by the IORP in a stress situation. In other words, they act as a substitute for financial capital."</i>	
Q3.	<p><b><i>Do stakeholders believe that the draft technical specifications provide enough information and are sufficiently clear and understandable? Which parts could be improved upon?</i></b></p> <p>Due to their complexity, the draft technical specifications are only understandable for experts. This may lead many IORPs to decide not to participate in the QIS, especially smaller IORPs and those who tend to outsource their operations. The result may be an unrepresentative picture of the quantitative impact of the proposed regulations.</p> <p>The main driver of the quantitative impact of the proposed regulations will be the discount rate used to calculate the best estimate of liabilities. This relatively straightforward calculation could be carried out by all IORPs and explains the largest part of the impact. The remaining items are less influential but highly time-consuming. EAPSPI therefore suggests to focus on the discount rate.</p>	
Q4.	<p><b><i>Do stakeholders believe that the calculations proposed in the technical specifications are feasible at appropriate costs and with appropriate accuracy within the given timeframe of the QIS?</i></b></p> <p>Generally, the proposed calculations are not feasible, as qualified staff and the financial resources to undertake the calculations needs to be available. Here again, EAPSPI doubts whether the final</p>	

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	<p>QIS will reach a representative number of IORPs across Europe and in particular, small IORPs with limited capacities. Against the background of the limited time frame for the execution of the QIS however, collecting the necessary data may be a challenging task for staff and IT systems. In addition, asset management departments may not have the necessary data at their disposal in such a granular way as needed e.g. for all risk sub-categories of a market risk category.</p> <p>Altogether, a lot of effort is needed which may be an excessive demand, especially for smaller IORPs as can be found in the public sector. Therefore, EAPSPI is concerned that the QIS may be too complex and that in particular smaller IORPs will not be able to participate without external assistance.</p>	
Q5.		
Q6.	<p><b><i>Given the purpose of the QIS, do stakeholders consider the proposed simplifications for the valuation of the holistic balance sheet (for the risk margin in section 2.5, sponsor support and pension protection schemes in 2.6 and amounts recoverable from insurance in 2.7) adequate? Do you have suggestions for additional simplifications that would be appropriate?</i></b></p> <p>The proposed simplifications for the valuation of the holistic balance sheet illustrate the general conflict: the original goal of the Solvency II structure and the HBS is to precisely measure the specific risk profile of an IORP and its security mechanisms. Simplifying the original structure only suggests better risk measuring. However, the intended objective can not really be achieved.</p> <p>Naturally, simplifications reduce the difficulty of carrying out complex calculations and thus practically implement the notion of proportionality. They may also help IORPs to be less reluctant to participate in the QIS. However, <b>the various simplifications indicate that certain concrete measures are not feasible and/or possible.</b> Simplifications play a prominent role concerning the measurement of concrete values of the HBS and the loss-absorbing capacities of IORPs security mechanism state. This is due to the general problem of evaluating the specific security mechanisms of IORPs, i.e. the future payments of sponsors.</p>	

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A **combination of various specifications and on-top-adjustments increase the question of practicality and possibility**, e.g. the matching premium, the counter cyclical premium, or the option of the duration-based approach for equity risk; see also EAPSPI's answer to Q13. And that the **contested 1-year time horizon of the SCR** of Solvency II should be applied also for IORPs, is due to the reason that *"no superior alternative or analysis could be identified as to date"* (see EIOPA's EIOPA-CP-11/006 consultation document on the IORP review, page 277).

The aspects mentioned indicate that the Solvency II structure is not appropriate for regulating IORPs. Therefore several questionable adaptations are made.

Using simplifications, adjustments and other practicality aspects casts a different light on the current IORP directive: The use of simplifications and adjustments leads back to a more practicable approach. EAPSPI therefore suggests to reconsider the regulatory approach of IORP I and reevaluate its pragmatic approach which is easy to implement at low cost and makes a regulation of all IORPs possible. **If a higher security level is considered to be necessary it can be easily achieved by adjusting parameters within the framework of the existing IORP directive.** Simplifications and adjustments are – in EAPSPI's opinion – contradictory to the Solvency II structure that targets precise measurement of the risks of IORPs notably by means of quantitative requirements.

(see for a more in depth answer to the question of the valuation EAPSPI's answer to Q10)

Q7.

Q8.

Q9.

Q10.

***The technical specifications propose that security mechanisms should be valued on a market consistent basis, i.e. by calculating the probability-weighted average of (discounted) expected***

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**mechanisms will be able to pay the moment they have to. But this depends on future developments which cannot be foreseen.** Although the calculated numbers seem to be more precise than a solely qualitative assessment, it may be doubted concerning future events like expected payments of sponsors or of a pension protection scheme in a 10, 20 or 40 year time frame. So the objective of the Commission and EIOPA to precisely assess and quantify the true risk position of IORPs only seems to be reached where in fact it is not. That this pseudo-precise basis mechanically triggers capital requirements or regulatory actions is problematic.

With respect to the market-consistent valuation of **sponsor support**, EIOPA tries to estimate the maximum value that a sponsor will be able to pay. Thus, future profits of the sponsor need to be quantified for calculating expectable payments adjusted for default probability. EIOPA suggests amongst others to use a proportion of expected net profits or of the earnings before taxes, depreciations and amortization (EBTDA). EAPSPI would like to emphasise that in general, it is problematic to quantify future profits. In addition, public sector institutions as sponsors generally are non-profit institutions and reliable values of future profits therefore questionable. The EBTDA are supposed to be calculated from the average of the most recent three years data. Three years of economic downturn will provide bad expected cash-flows and the other way round and transpose to the IORPs balance sheet via the value of the sponsor support asset.

A further problem in EAPSPI's opinion is that through the recourse on credit ratings as an indicator for measuring default risks of sponsors (HBS.6.15 and HBS.6.36) **a new channel is created to transfer the fast changing assessment of capital markets and thus the volatility and short-term financial frictions into the balance sheets of IORPs.** E.g. EIOPA suggests calculating the EBTDA starting from the *most recent three years data*, see above. This "risk-sensitive" consideration of the sponsor support also has pro-cyclical effects, e.g. in case of the downgrading of the sponsor and the likely response of the IORP. This import of balance sheet volatility aggravates the problems of market-consistent valuation of all other assets under the Solvency II-structure. It is highly questionable, if short-term changes in financial positions and credit risks are reliable sources for such a long-term commitment that the sponsor support constitutes.

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	<p>With respect to the pension protection scheme the valuation is clear. The value of the pension protection scheme in the HBS is set as the coverage rate times the Level A technical provisions (HBS.6.70) so the <b>value of a pension protection scheme</b> with a 100%-coverage rate <b>“is equal to the funding gap that would appear in the holistic balance sheet”</b>. The pension protection scheme is supposed to close this gap (HBS.6.71). According to EAPSPI, <b>it does not need the HBS to reach this conclusion</b> which is in line with EIOPA’s reference to a <i>“sufficiently strong”</i> pension protection scheme (HBS.6.71).</p> <p>As a consequence, another aspect of the QIS becomes evident concerning the long-term character of IORPs: the <b>attempt to reduce “uncertainty” to “risk”</b>. Risk can be handled by calculations whereas uncertainty cannot. This is in line with the economic debates of many decades. Due to the nature of uncertainty the values measured only seem precise: in the discussion of assessing the model error of using certain methods/simplifications when valuing the HBS and calculating the SCR (PRO.3.18), EIOPA addresses the problem of finding appropriate future values while it is conceptually unclear how to proceed <i>“leading to a certain degree of inaccuracy and imprecision in the measurement.”</i> (PRO.2.3). EIOPA also suggests caring for a qualitative assessment in form of <i>“reasonable assurance”</i> (PRO.3.23) of the model error or <i>“expert judgments”</i> (PRO.3.23) when applying certain methods/simplifications for the calculation. So EIOPA, too, implicitly recognizes the fundamental problem of exactly quantifying the risk mitigating effects due to the nature of long-term liabilities and investment horizon of IORPs, or more generally, of the fundamental uncertainty connected to pension business.</p>	
Q11.	<p><b><i>Do stakeholders have suggestions for the parameters – such as the probability of default and the recovery rate in the event of default – used in the valuation of sponsor support and pension protection schemes (Section 2.6)?</i></b></p> <p>EAPSPI finds that the valuation of sponsor support is ill-designed particularly for multi-employer IORPs. The exposure of multi-employer IORPs to single default risks (i.e. all sponsors defaulting at the same time) is basically non-existent. In addition, a thorough examination of possible default risks is very time-consuming and costly for multi-employer IORPs. The valuation of the default</p>	

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	<p>risks given in the QIS for each supporting employer is disproportionate. The approach in section 6.35 to make calculations only for a sufficient number of (larger) employers is neither helpful nor necessary regarding multi-employer IORPs.</p> <p><b>EAPSPI would like to stress that many public sector IORPs are multi-employer IORPs</b> involving a large number of sponsors. For example, the supplementary pension scheme for public employees in Bavaria covers 5,500 employers and the supplementary pension scheme of the German Catholic Church 8,700 employers. The total number of pure public sector employers in Germany sums up to around 26,000 employers covering a huge variety of employers. Here, too, the question arises how to evaluate the financial solidity and the probability of default of a public employer in general. These aspects must be accounted for in case of multi-employer IORPs and public sector IORPs.</p>	
Q12.	<p><i><b>Do stakeholders agree with the methodology set out to value the maximum value of sponsor support (Section 2.6)? Do stakeholders have suggestions for the parameters used in valuing the maximum amount of sponsor support? In particular, with regard to the proportions of future profits / EBTDA and the time period of the calculations.</b></i></p> <p>See answer to Q10.</p>	
Q13.	<p><i><b>The draft technical specifications propose performing an upward shift in the basic risk-free interest rate curve to approximate the so-called counter cyclical premium or to allow IORPs – under conditions – to apply the so-called matching premium (Section 2.8). Do stakeholders agree with this approach to take into account the long-term nature of pension liabilities?</b></i></p> <p>EAPSPI welcomes EIOPA's attempt to reach a higher discount rate for valuing pension obligations as it lowers the burden of the inappropriate and immense increase of the value of technical provisions when calculated with the fictitious basic risk-free interest rate. However, <b>a vertical shift in the yield curve still transfers the volatility</b> of market interest rates into the balance sheets of IORPs. Thus <b>the counter cyclical premium and the matching premim</b> are not appropriate for</p>	



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	<p>IORPs as they do <b>not take into account appropriately the long-term nature of pension liabilities</b>: The general inappropriateness of Solvency II's pillar I and the SCR for IORPs cannot be solved by allowing for some adjustments for an inappropriate structure. The necessity of introducing a markup on the discount rate to reflect somehow the long-term nature of pension liabilities seems to be arbitrary. It is necessary to include the specific characteristics of IORPs: <b>the stability and the long term character of liabilities lead to long reaction periods and investment horizons of IORPs that strongly mitigate various risks IORPs are facing</b>. The structure of Solvency II does not properly reflect this substitutional character.</p>	
Q14.	<p><b><i>Do stakeholders agree that the proposed way to derive the level B discount rate adequately reflect the expected return on assets of IORPs (Section 2.8)? If not, what alternative would you propose?</i></b></p> <p>EAPSPI in general welcomes the notion of Article 15 (4) lit. b) of the IORP Directive 2003/41/EC in the level B discount rate and the reference to the expected long term return on IORPs' assets (<i>"the yield on the corresponding assets held by the institution and the future investment returns and/or the market yields of high-quality or government bonds"</i>). In contrast to the intended unification of the calculation of the level B discount rate, EAPSPI is of the opinion that the hitherto <b>reference to the rules of the home member state should be maintained</b> (<i>"the maximum rates of interest used shall be chosen prudently and determined in accordance with any relevant rules of the home Member State"</i>).</p> <p>EAPSPI disapproves of using the basic risk-free Level A-interest rate. The current low interest rate environment of swap rates generates uniquely high technical provisions while at the same time the very existence of a "risk-free" asset and interest rate is questionable in the light of current debates concerning i.e. the government bond markets of Euro countries and the volatility of financial markets. EAPSPI suggests only referring to the notion of long term expected returns of IORPs assets and not referring to short term fluctuations in yield levels.</p>	

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Q15.	<p><b><i>Do stakeholders agree that the draft technical specifications specify a fixed yearly percentage of respectively 2% and 3% for the expected inflation rate and salary growth? Or should IORPs also be allowed to expected inflation implied by financial markets? Could you explain?</i></b></p> <p>EAPSPI believes that all assumptions should be based on a stable and long-term perspective.</p>	
Q16.	<p><b><i>Do stakeholders believe that the description of the SCR in Chapter 3 is sufficiently clear and understandable to enable participants in the QIS to perform the necessary calculations?</i></b></p> <p>EAPSPI finds the structure of the SCR section clear and understandable only for qualified staff. Many IORPs will be overwhelmed by it. Here again, EAPSPI doubts whether the final QIS will reach a representative number of IORPs across Europe and in particular, small IORPs with limited capacities.</p>	
Q17.	<p><b><i>Do stakeholders believe that the risks IORPs are facing are adequately reflected in the calculation of the SCR and MCR (Chapter 3 and 4)? Are there in the stakeholders' view any risks being considered that are not material and could be excluded from the technical specifications? Are there other risks that should be considered in the calculation of the SCR?</i></b></p> <p>EAPSPI does not believe that the risks IORPs are facing are adequately reflected in the calculation of the SCR and MCR (Chapter 3 and 4). The reflected risks and their assessment are those of insurance undertakings. The risks IORPs are facing and the structural differences of IORPs and insurance undertakings, however, are not regarded. The approach is therefore not adequate as it does not adequately reflect the risks of IORPs. This general problem of pillar one of Solvency II may not be solved by allowing for some adjustments (e.g. the introduction of the matching premium, the counter cyclical premium or the duration-based approach for the equity risk as discussed in Q13) within an inappropriate structure.</p> <p>For Solvency II and the IORP QIS, risks are measured and financially valued by the change in "Net Asset Value" when a specific risk occurs. Essentially, the net value of the change in all future cash-</p>	

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flows is calculated and required as solvency capital (SCR.1.7 and 1.8). As a result, an IORP is forced to permanently hold available the full (net) value of all future consequences caused by the risk occurrence although the **actual payments fall due only gradually in the future**. But even against the Solvency II background of assuring solvency for one year at a 99.5 % security level (non-default probability) IORPs will not need all the capital to cover the risk because of a much **longer reaction period**. IORPs are nevertheless able to deliver the same security level. This holds true for several of the risk categories, in particular for two of the most relevant risks for IORPs: the **interest rate risk** and the **longevity risk**.

The “change in Net Asset Value”-approach would only make sense if IORP’s liabilities were transferred to another undertaking. But EIOPA stated in its Advice to the Commission that the “transfer principle” of Solvency II conceptually is not reasonable for IORPs and therefore will not be used as valuation criterion. **This decision also implies not to use the “cost of capital” concept** to determine the risk margin on top of the best estimate of the technical provisions (HBS.5.1) as this concept also rests on the transfer notion. The risk margin upon the best estimate component for the calculation of technical provisions reflects the additional funds necessary only in case of the disposal and transfer of liabilities of one IORP to another financial institution. However, there is no market as **liabilities of IORPs are not sold**. Hence no external capital premium is needed.

Again, the “change in Net Asset Value”-approach and the “cost of capital”-risk are reasonable for regulating insurance undertakings as their liabilities might fall due very quickly and thus capital has to be available. However, for IORPs there is no need for such short-term cushioning. The stability and long term character of liabilities and thus the investment horizon of IORPs include strong risk mitigating effects. The long term character of the occupational pension business makes these effects hardly measurable and financially quantifiable. The existing security mechanisms for IORPs deliver a high degree of flexibility to account for this indeterminacy that Solvency II does not. The VaR approach developed for measuring short term trading risks and thereupon the calculation of the SCR do not integrate these effects properly. Moreover, they lead to excess and inflexible capital requirements.

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Q18.	<p><b><i>Do stakeholders believe that the way the loss-absorbing capacity of adjustment mechanisms and security mechanisms is taken into account in the calculation of the SCR (Section 3.2) is adequate?</i></b></p> <p>EAPSPI does not believe it is adequate. The idea of sponsor support and pension protection schemes is to deliver a flexible financial “back-up facility”. This provides for a very flexible risk mitigating mechanism and insolvency protection without necessarily having all potentially needed capital available at all times. These features form the general character of the additional “assets” IORPs dispose of.</p> <p>This aspect is not included properly in the structure of Solvency II and thus the HBS. The differentiation of the value of the security mechanisms in the HBS in “normal times” and their loss-absorbing capacity “stress situations” in the SCR as laid out in the QIS seems artificial. IORPs are thus able to close their balance sheets in normal times (therefore the first part) and they are able to fulfill the SCR under stress (therefore the second part). This dichotomy is necessary only because of conceptualizing sponsor support and pension protection scheme as financial assets that have to fit into the Solvency II structure and once more indicates that this structure is not adequate for the regulation of IORPs.</p>	
Q19.		
Q20.	<p><b><i>Do stakeholders believe that the simplifications provided for the calculation of the SCR (for spread risk on bonds in section 3.5, value of collateral in section 3.6 and mortality, longevity, benefit option and catastrophe risk in section 3.7) are adequate? Do stakeholders have any concrete suggestions for additional simplifications?</i></b></p> <p>See answers to Q6 and Q13.</p>	
Q21.		

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Q22.		
Q23.		