

**Comments Template on
Consultation Paper on Further Work on Solvency of IORPs**

**Deadline
13 January 2015
23:59 CET**

Name of Company:	Nematrian	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
<p>Please follow the following instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ 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 <u>empty</u>. ⇒ Please fill in your comment/response in the relevant row. If you have <u>no response</u> to a question, keep the row <u>empty</u>. ⇒ Our IT tool does not allow processing of comments/responses which do not refer to the specific numbers below. <p>Please send the completed template, in Word Format, to CP-14-040@eiopa.europa.eu . Our IT tool does not allow processing of any other formats.</p> <p>The numbering of the questions refers to Consultation Paper on Further Work on Solvency of IORPs.</p>		
Reference	Comment	
General Comment	<p>We have had the opportunity to contribute to responses that other organisations are making to this Consultation Paper. We have therefore limited our comments to a narrow subset of questions relating to whether and how the Holistic Balance Sheet should "balance".</p> <p>We believe that decisions of the sort discussed in the Consultation Paper are helped if they are informed by a clear conceptual framework. We believe that the framework set out in Kemp (2014) "Capital Adequacy: a conceptual framework" offers such a framework. It recommends that the problem of how much capital or access to other security mechanisms an organisation needs if it is to be deemed 'solvent' should ideally focus on the notional yield spread (versus the risk-free rate) that would or should apply to the organisation's liabilities were they to be traded freely in</p>	

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the market place. More practically it offers this concept as a benchmark which can be used to assess the solvency framework actually in place (or any alternative under consideration). The framework is conceptually applicable to a wide range of financial organisations including different types of IORP (and to insurers). Insights that such a conceptual framework offers in areas discussed in the Consultation Paper include:

- Access to sponsor support, pension protection schemes and building up assets within an IORP offer additional protection to beneficiaries and should ideally be included in the HBS. Each of these security mechanisms reduce the yield spread that the IORP beneficiaries might notionally expect to suffer if they hypothetically transferred their pension entitlements to others in the open market. Moreover, their “value” in the HBS (at least from the perspective of the beneficiary) should ideally link to the extent of the resulting reduction in this yield spread (or more practically should involve some approach that approximates the same broad outcome). In economic terms, a pension promise has bond-like characteristics and the credit-riskiness of a bond can be assessed by the credit spread to which it is subject.
- The mathematics of yield spreads does not work in exactly the same way as the mathematics of balance sheets. In particular, the relationship is non-linear. For example, if an IORP has assets of 10 and liabilities of 100 payable in 10 years time then the first 100 extra added to the assets is likely to improve the security of the liabilities (in terms of the fall in the yield spread applicable to the liabilities) much more than the next 100 or the 100 after that.
- The HBS should therefore somehow seek to bring all of the security mechanisms together to form a holistic assessment of the security / robustness of the pension promise, rather than value each mechanism separately and assume that these separate values can simply be added together as in an accounting balance sheet.

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Q39	<p>See our general comments. We think that the idea of allowing sponsor support to provide a balancing item should be benchmarked against the security that the sponsor support offers in conjunction with other security mechanisms. Assets built up within the IORP should be viewed as just another such security mechanism for this purpose. As long as the overall level of security is sufficiently good (with this security ideally being measured by reference to the spread versus risk free implied on the relevant liabilities) then the sponsor support (or indeed any other security mechanism present) should be allowed to provide the balancing item. This would seem to imply that treatment of sponsor support should take into account all of the following and not just one or both of the Principles mentioned in the preceding paragraphs:</p> <ul style="list-style-type: none"> • The expected (longer-term) default rate of the sponsor (Principle 1) • The size of the sponsor in relation to the IORP shortfall (Principle 2) • The size of the IORP shortfall in relation to the IORP's overall liabilities (i.e. how close the HBS was to balancing without allowing for sponsor support) • The extent to which the security is enhanced by the presence of other security mechanisms 	
Q40	The sponsor support should be treated as a balancing item if the combination of all the security	

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	<p>mechanisms (including assets within the IORP) is sufficient to meet the target degree of security (and as long as no other security mechanism is being used as the balancing item).</p> <p>For example, even if the sponsor had a poor credit rating, it should still be possible to take some credit for sponsor support (in the terminology used here, to use it to “balance” the HBS) as long as other security mechanisms in aggregate are sufficiently close to delivering the desired target degree of security (on the grounds that some access to sponsor support, even if it is weak, is still better than none, from the perspective of the beneficiary).</p>	
Q41	Yes. If the combination of all the security mechanisms (including assets within the IORP) is sufficient to meet the target degree of security and if there are no other security mechanism being used as the balancing item (even if the sponsor support does not meet the principles set out in 4.114 – 4.133).	
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