Comments Template on Consultation Paper on Further Work on Solvency of IORPs		Deadline 13 January 2015 23:59 CET
Name of Company:	Pension Protection Fund	
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/response in the relevant row. If you have no response to a question, keep the row empty. ⇨ Our IT tool does not allow processing of comments/responses which do not refer to the specific numbers below. **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.** The numbering of the questions refers to **Consultation Paper on Further Work on Solvency of IORPs**.	
Reference	**Comment**	
General Comment	This document sets out the response to the consultation by the UK’s Pension Protection Fund (“PPF”). The PPF is a statutory fund run by the Board of the Pension Protection Fund, a statutory corporation established under the provisions of the Pensions Act 2004. The PPF’s main function is to provide compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer, and where there are insufficient assets in the pension scheme to cover the PPF level of compensation. To help fund the PPF, compulsory annual levies are charged on	

	all eligible schemes. While we support any measure to improve the level of funding in defined benefit pension schemes, we are concerned that some of the proposals made in the consultation could come at the cost of increased insolvency rates. We appreciate that assessing whether funds are better invested in the scheme or in the employer's business is a delicate balancing act for scheme trustees and regulators. We believe the transitional and grandfathering arrangements would be essential in the UK for some of the proposed designs. For example requiring deficits to be made good within twelve months would send a high proportion of scheme sponsors insolvent. Since the PPF provides less than 100% of coverage for scheme benefits and many schemes are underfunded at present, this would be to the detriment of scheme members as well as having wider economic impacts. It is difficult to comment on the technical details concerning the Holistic Balance Sheet without knowing the purpose for which the balance sheet will be used. We believe that the purpose of the balance sheet needs to be clarified before any detailed work on the technical work could be usefully taken forward. If the Holistic Balance Sheet were used for funding or solvency purposes, then it would not be appropriate to place the PPF on a scheme's balance sheet. This is because the PPF is not a contingent asset of the scheme but rather a compensation fund for members whose pension schemes have failed. Scheme trustees should operate "blind" to the compensation we would pay following a scheme failure. If the Holistic Balance Sheet were used for reporting security of benefits to members, however, we can see an argument for including the PPF on the balance sheet. However, this should not come at the cost of increased	

	complexity. The Experian Model we commissioned is mentioned as a possible method for calculating insolvency probabilities for employers for use in a larger model that assesses the value of sponsor support. However, we would warn against this as the model was built for the specific purpose of helping us distribute the PPF levy. It is likely that a different model would be needed for assessing the creditworthiness of sponsors for a pension scheme solvency valuation. Many of the proposals in the consultation would be complicated to produce, and in a UK context the benefits would be outweighed by the costs for a great many, if not all, schemes. In the UK most defined benefit schemes are relatively small, with around 5,000 (circa 80 per cent) having fewer than 1,000 members and around 2,000 having fewer than 100 members. Any regulatory system should be designed with this in mind.	
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Q35	In the UK, defined benefit schemes with a solvent sponsor cannot reduce benefits in respect of past service (except with the explicit consent of the relevant beneficiaries). Past service benefits can only ever be reduced when the scheme's sponsor becomes insolvent and the pension scheme is wound up. At that stage, reduced benefits are secured with an insurance company or	

members receive compensation from the PPF if the pension scheme has insufficient assets to secure at least the level of benefits that the PPF would provide (in which case the scheme ceases to exist and its assets transfer to the PPF).

If the above mechanism was treated as a benefit reduction mechanism for the purpose of constructing the Holistic Balance Sheet, there is a danger that Trustees and sponsors of defined benefit pension schemes would regard the reduced level of benefits as a target for funding and solvency of the pension scheme. This is not the intention of the UK pension regulatory environment. Trustees and sponsors of pension schemes should be targeting full scheme benefits. Any relaxing of this target might have a detrimental effect on the funding and security of member benefits and hence lead to members not receiving their full accrued scheme benefits.

This issue may not apply in the same way across the various pension regimes across Europe. Hence, it might be preferable to allow the individual Member States to decide whether to include benefit reduction mechanisms in the Holistic Balance Sheet or not.

However, if benefit reduction mechanisms were to be allowed for in the Holistic Balance Sheet, the approaches set out in the consultation paper are reasonable.

We note that in the UK trustees have fiduciary duties to act in the best interests of the scheme beneficiaries, which means that they have a duty to seek to enable the scheme to meet the full benefit promise. Having benefits in the balance sheet reduced to the level of protection provided by the protection scheme (where this is less than 100%) could, depending upon the way in which the balance sheet is used, conflict with that fiduciary duty. Also, UK case law (the case of ITS v Hope) decided that trustees cannot use the existence of

	the PPF to justify actions that would otherwise be improper so including the PPF in the balance sheet could potentially – again depending on the way in which the balance sheet is used - be in conflict with UK law.	
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Q43	We agree that a pension protection scheme could in principle be considered as impacting on sponsor support to allow it to be a balancing item on the Holistic Balance Sheet. We also agree that, in order to allow it to be a balancing item, the pension protection scheme needs to be financially strong and based on sufficiently permanent and certain legal arrangement. We believe that the determination of financial strength and permanence should be carried out at state level.	

	In our case we don’t believe it appropriate to include the PPF on the Holistic Balance Sheet for funding or solvency purposes because of the format of protection we provide, i.e. we step in to compensate members when their pension schemes have insufficient funds to pay the pensions promised following a sponsor’s insolvency at which point the scheme ceases to exist. The trustees should not be running the scheme finances taking into account any compensation payable following the scheme’s disappearance, and to include us on the balance sheet would run the risk that trustees and employers came to target PPF levels of compensation (which are less than 100% of full scheme benefits).	
Q44	In cases where protection is 100% we can see that inclusion of the pension protection fund on the balance sheet is less problematic as it avoids the risk that scheme managers will target a level of benefits less than the full scheme promise. However we do not think this prevents including on the balance sheet a pension protection scheme that protects less than 100% of scheme benefits – so long as it is not used as the basis for funding/solvency requirements.	
Q45	We agree that it is appropriate that where a pension protection scheme is used as the balancing item, a separate minimum level of funding with financial assets and/ or sponsor support should be required. In particular, we would be concerned that the incentive for Trustees and sponsors of pension schemes to properly fund or otherwise support their pension scheme would be reduced if there were no minimum funding requirement and the scheme’s Holistic Balance Sheet always balanced. Such a reduced incentive would be likely to lead to increased risks for the PPF.	
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Q60	The PPF-specific model used to assess sponsor insolvency probabilities has been developed to determine the risk-based levy IORPs should pay for the protection provided by the PPF. In particular, it is used to divide the total levy required each year between all of the IORPs covered. Hence, it has been developed to assess the likelihood of the employer failing over a one-year period rather than being developed with valuation of employer support in mind. It is also important to note that the PPF-specific model is an evidence based, statistically driven model for scoring over 10,000 employers. As such, it cannot provide a bespoke assessment that may be necessary to reflect the unique position of individual entities. As such, we do not think our model is suitable to be used for this quite different purpose. The PPF-specific model has also been calibrated using the specific characteristics of the UK's population of defined benefit sponsors, which may differ from those in other EU countries, as may insolvency experience. In addition, the data used in constructing scores was chosen based on what is published in the UK, and we are aware of variables that are not reported in other EU states. However, we would be happy to share our experiences of setting up such a model with EIOPA.	

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Q69	We do agree with the comments set out in this section. We also note that the correct treatment of a pension protection scheme depends crucially on the purpose for which the holistic balance sheet is being used, as well as the nature of the pension protection scheme. For example a scheme that compensates members for losing their pension following a scheme failure is fundamentally different from a protection scheme that contributes assets to a	

	scheme whilst it is still in existence.	
Q70	In the case of the UK, the second approach is not appropriate as we pay compensation which is (almost always) lower than the full benefits promised by the IORP. Assuming that the sponsor never defaulted would therefore give false certainty as to the security of members' benefits. More generally we believe the approach of placing a separate value on the pension protection scheme to be theoretically better, although we note the difficulty and potential costs of carrying out such a calculation, particularly for smaller IORPs. One pragmatic concession would be to permit a zero valuation where the costs were considered disproportionate. We should note that in the UK, IORPs pay us a levy to finance the protection offered. We believe in such cases IORPs should include in their liabilities an estimate of future levies, as to do otherwise would overstate the net benefit offered by pension protection schemes. We do not believe that the PPF should be included on schemes' balance sheets for the purpose of funding or solvency measurement. As we have stated elsewhere, we provide compensation to members following a scheme failure, and trustees should be running their schemes with the intention of meeting the full benefit promise, rather than failing and members having to receive reduced compensation for their lost pensions.	
Q71	Yes, we believe that in principle this would be appropriate, depending on the level of protection offered and the security of the protection scheme. We do not believe that in the UK that the PPF could be considered a balancing item because, as noted above, we pay compensation that is lower than full IORP benefits, although we note paragraph 4.4 of section 4.1.2. which says	

	"There are several elements that could, under specific circumstances, serve as a balancing item … a pension protection scheme that covers 100% of benefits (or a pension protection scheme that covers <100% but the reduction in benefits is accounted for in the valuation of the holistic balance sheet) and is valued separately (from sponsor support) on the holistic balance sheet". For the reasons set out in various other sections, we believe that the PPF should be excluded from the holistic balance sheet if the purpose of the balance sheet is funding or solvency. This is because we compensate members for lost pension rather than contribute assets to the scheme, and trustees should not run their scheme in such a way that factors the scheme's failure into the level of funds they require. Finally, we would be concerned if treating a pension protection scheme as a balancing item inadvertently led to IORPs receiving lower levels of financial support from sponsors where it was not the Member State's intention to socialise the financial risk in this way.	
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Q77	We believe that it depends on the nature of the pension protection scheme and the purpose to which the balance sheet is being put. As we have stated elsewhere, in our case the PPF should not be put on the balance sheet for funding or solvency purposes. This is because we provide compensation to members following a scheme failure, and trustees should be running their schemes with the intention of meeting the full benefit promise, rather than failing and members having to receive reduced compensation for their lost pensions. We agree with EIOPA's suggestion in this section that a solvency framework should not attempt to minimise the risk of employer insolvency, although as a general point we note that the best long-term support for a pension scheme is a solvent sponsor. We believe the supervisory framework should attempt to align the members' and sponsors' interests and acknowledge the shared interest in the long-term existence of the sponsor.	
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Q80	We believe option 2 is best suited to the diversity of different pension arrangements across Member States. For example in the Dutch pension system the benefits may be reduced by the IORP as a last resort, whereas in the UK where there is a solvent sponsor accrued benefits can only be reduced with the consent of the beneficiaries. It seems to us that the supervisors in the different Member States should have the flexibility to decide whether or not to include ex post reductions depending on the likelihood of their being applied.	

	As a point of detail, we do not consider the reduction to retirement income following entry to the PPF to be as a benefit reduction *per se*, but rather the disappearance of the pension and its replacement by a different kind of income, i.e. compensation for the failure of the pension scheme. We do not think it would be appropriate in the case of the UK to include an element in the balance sheet to reflect the loss of pension income following entry to the PPF. Regardless of how the balance sheet is used by regulators, we believe it should be the pension promise that is accounted for rather than any alternative income that scheme members would receive following the failure of the pension scheme.	
Q81	No, we believe that all sensible permutations have been covered. One option would be to exclude all benefit reduction mechanisms, including ex ante arrangements. However, we do not think this would accurately reflect the nature of the pension promise.	
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