	Comments Template on EIOPA-CP-11/006 **Response to Call for Advice on the review of Directive 2003/41/EC: second consultation**	**Deadline** **02.01.2012** **18:00 CET**
Company name:	Punter Southall Limited	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. *Please indicate if your comments on this CP should be treated as confidential, by deleting the word **Public** in the column to the left and by inserting the word **Confidential**.*	Public
	The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006). **Please follow the instructions for filling in the template:** ⇨ <u>Do **not** change the numbering</u> in column "Question". ⇨ Please fill in your comment in the relevant row. If you have <u>no comment</u> on a question, keep the row <u>empty</u>. ⇨ There are 96 questions for respondents. Please restrict responses in the row "General comment" only to material which is not covered by these 96 questions. ⇨ Our IT tool does not allow processing of comments which do not refer to the specific question numbers below. ○ If your comment refers to multiple questions, please insert your comment at the first relevant question and mention in your comment to which other questions this also applies. ○ If your comment refers to parts of a question, please indicate this in the comment itself. **Please send the completed template to *CP-006@eiopa.europa.eu*, <u>in MSWord Format</u>, (our IT tool does not allow processing of any other formats).**	
Question	**Comment**	
General comment	This is Punter Southall's response to the consultation paper. Punter Southall provides a full range of actuarial advice, pensions consultancy and pensions administration services. Our clients come from a broad spectrum of UK businesses, charities, unions and institutions. Pension scheme clients range in	

size from 20 members to over 10,000 members, from owner-managed businesses to industry-wide schemes.

Given the length of the consultation and the comparatively short timescale in which to make a response, we have had to restrict our response to a few comments on what we consider to be the most important areas of the consultation.

Our fundamental point is that we do not agree that Solvency II, a solvency regime designed for insurance companies, should be adapted to apply to IORPS. Introducing a Solvency II style regime is highly likely to have severe and disproportionate consequences for defined benefit pension schemes, their sponsoring employers and the wider economy.

Pensions are different from insurance – the regulatory regime should reflect this

The terms of reference for the current consultation appear to be a step ahead of themselves as EIOPA has been asked to consider **how** to adapt Solvency II for pensions and not **whether** this is appropriate in the first place.

We note that EIOPA's draft response to the European Commission accepts that there are 'important differences between IORPS ... and insurers' (2.6.4). We agree with this view. It is very hard to see how IORPs and insurance companies can be viewed as being in competition with each other, given that IORPS are associated with an employer and employees are typically only offered the option of joining an employer's pension scheme (or not).

In our view, IORPS should be regulated by bespoke regulation tailored to their particular situation, not forced into an ill-fitting framework designed for a completely different sort of institution.

The proposed holistic balance sheet attempts to make the Solvency II framework fit IORPs better, by allowing for the valuation of additional forms of security which are unique to IORPs, such as sponsor covenant and pension protection schemes. It is certainly true that such security mechanisms are a fundamental part of the risk-mitigation framework that applies to IORPs. The holistic balance sheet does not, however, address the fundamental inappropriateness of starting from a framework designed with a completely different type of financial vehicle in mind.

Introducing Solvency II would have severe consequences for UK DB schemes

Punter Southall carried out research a few years ago (December 2007) that suggested increasing technical provisions for the UK FTSE350 to Solvency II levels (taking account of both a switch to a risk-free discount rate and the introduction of a solvency capital requirement) could lead to an increase in funding of 85-90% compared to technical provisions on the scheme specific funding basis. Although things have moved on since then, particularly in terms of market conditions, this figure suggests that the potential impact on defined benefit schemes would be enormous. It is not implausible to suggest that it would result in the widespread closure of defined benefit schemes to new entrants/future accrual, if this has not already happened.

We also note with some dismay that EIOPA propose to provide advice to the EC **before** carrying out a quantitative impact assessment. This is a clear-cut case of putting the policy advice cart before the impact assessment horse.

A move to a solvency-style regime is also likely to impact on pension scheme asset allocation, with schemes increasingly reluctant to invest in return-seeking assets such as equities, property and corporate debt in preference to sovereign debt. This could have serious effects on the wider economy, which could be particularly unwelcome at a time when the markets are already suffering sustained and damaging effects from the EU sovereign debt crisis.

European Commission's aims for pensions

According to its Green Paper for Pensions, the EC's goals for pensions are adequacy, sustainability and safety. Whilst introducing Solvency II for pensions would increase the security of some IORPS, it could be at a considerable cost for defined benefit pension schemes (and their members) as mentioned above. Sponsors would be likely to close defined benefit schemes. If the replacement schemes are comparatively poorly resourced defined contribution schemes, where the member runs all the risks, it is hard to see how this can be squared with the goals of adequacy and sustainability.

It is also difficult to see why introducing Solvency II for IORPS would increase take-up of cross-border schemes. Increasing funding requirements for defined benefit IORPs would be likely to reduce take-up not increase it. We suggest that the EC would be better advised to investigate other reasons as to why there are so few cross-border schemes, such as a possible lack of demand.

Level A and Level B technical provisions

Although we fundamentally disagree with the introduction of Solvency II for IORPS, if EIOPA decide to recommend the holistic balance sheet regardless, we strongly urge them to consider adopting the

	alternative valuation approach with two levels of technical provisions (level A and level B) where 'Level B technical provisions', calculated using an interest rate based on expected asset returns, are used as the basis for the funding of IORPS, whereas Level A technical provisions are calculated solely for the purpose of disclosure to members and supervisors. **Summary** To conclude, we fundamentally disagree with the basic premise of this consultation that a regulatory regime based on Solvency II should be imposed on IORPS. We strongly urge EIOPA (and the EC) to reconsider their stance on this point.	
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12.	In our view, IORPS should be regulated by bespoke regulation tailored to their particular situation, not forced into an ill-fitting framework designed for a completely different sort of institution. The proposed holistic balance sheet attempts to make the Solvency II framework fit IORPs better, by allowing for the valuation of additional forms of security which are unique to IORPs, such as sponsor covenant and pension protection schemes. It is certainly true that such security mechanisms are a fundamental part of the risk-mitigation framework that applies to IORPs. The holistic balance sheet does not, however, address the fundamental inappropriateness of starting from a framework designed with a completely different type of financial vehicle in mind. In our view,	

	pensions should be regulated by a regime designed specifically for pensions, not a regime designed for insurance that has been crudely hacked around to make it look a little more appropriate to pensions. We believe that the distinction between Article 17 schemes and sponsor-backed schemes should be retained, and that a regulatory approach designed specifically with pension schemes in mind should continue to be applied to IORPs.	
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21.	Although we fundamentally disagree with the introduction of Solvency II for IORPS, if EIOPA decide to recommend the holistic balance sheet regardless, we strongly urge them to consider adopting the alternative valuation approach with two levels of technical provisions (level A and level B) where 'Level B technical provisions', calculated using an interest rate based on expected asset returns, are used as the basis for the funding of IORPS, whereas Level A technical provisions are calculated solely for the purpose of disclosure to members and supervisors.	
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33.	It is certainly true that the sponsor covenant is a fundamental part of the risk-mitigation framework that applies to IORPs. However, we do not see the need for a formal valuation of the sponsor covenant as part of a holistic balance sheet. Rather, the existence of the sponsor covenant constitutes a fundamental difference between IORPs and insurance and indicates that an approach based on Solvency II for IORPs is completely inappropriate.	
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36.	It is not appropriate to introduce a uniform security level across Europe, given the significant differences in the nature and coverage of IORPs in individual member states. Solvency capital has no place in a system where an IORP already has the backing of a solvent employer (and possibly of a pension protection scheme at member state level).	
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41.	It is certainly true that the existence of a pension protection scheme is a fundamental part of the risk-mitigation framework that applies to IORPs. However, we do not see the need for a formal valuation of the pension protection scheme as part of a holistic balance sheet. Rather, the availability of pension protection schemes demonstrates the fundamental difference between pensions and insurance, and highlights that it is inappropriate to apply insurance regulation to pensions.	
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44.	We do not believe that a Solvency Capital Requirement is applicable to sponsor-backed IORPS. Recovery plans do, however, have a part to play where assets are insufficient to cover technical provisions. Periods of up to 15 years may be appropriate, so long as security exists that the benefits will ultimately be paid (for example, in the form of the sponsor covenant and/or any payment protection scheme).	
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