

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:	Universities Superannuation Scheme (USS),	
Disclosure of comments:	EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential. <i>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.</i>	Public
<p>The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006).</p> <p>Please follow the instructions for filling in the template:</p> <ul style="list-style-type: none"> ⇒ <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. <ul style="list-style-type: none"> ○ 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. <p>Please send the completed template to CP-006@eiopa.europa.eu, in MSWord Format, (our IT tool does not allow processing of any other formats).</p>		
Question	Comment	
General comment	This response is from the trustee of Universities Superannuation Scheme (USS), which is the second largest defined benefit occupational pension scheme in the United Kingdom. USS is a scheme that provides benefits to more than a quarter of a million current and former employees within the UK's	

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higher education sector, with participating employers that include some of the world's most prestigious universities. The scheme has assets of more than £30 billion (€36 billion).

In responding to EIOPA's draft response to the Call for Advice from the European Commission on proposed changes to the IORP Directive (2003 / 41 / EC), we firstly wish to make clear our opposition to the proposed new quantitative requirements for the funding of IORPs, and in particular revised rules for the calculation of technical provisions and the determination of other additional capital requirements. The funding arrangements for defined benefit pension schemes in the UK, which are derived from those requirements set out presently in the IORP directive, have enhanced the way that pension commitments are funded and provided for, and this funding regime – whilst presenting many challenges for scheme trustees and their employer sponsors – works effectively. The Directive enables national supervisors to implement funding arrangements which are specific to their national structures, which is entirely appropriate for defined benefit occupational pension schemes where arrangements differ substantially between different countries.

USS is therefore opposed to the proposed changes, which are likely to be ruinous for defined benefit pension schemes operating in the UK, which together contain over £1,007 billion (€1,207 billion) of pension fund assets. The changes are unnecessary, as there are already substantial national arrangements in place for the funding of these schemes. Worse still, the entire proposal to introduce more demanding funding standards as well as new capital requirements under the Solvency II-style funding approach seems to be based on a fundamental misunderstanding that a "level playing field" is necessary between defined benefit pension schemes and insurers. This flawed ideology fails to recognise the particular structure and design of defined benefit schemes in those EU states (which include the UK and a small number of other states) which have a sponsoring employer (or employers) that provides the ultimate funding guarantee for the pension scheme in the event that additional financing is required. In addition, a substantial protection scheme exists in the UK to

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guard against the insolvency of the sponsoring employer(s). These arrangements make DB pension schemes in the UK fundamentally different to insurance undertakings, and the intended application of similar funding arrangements is patently inappropriate.

The proposals have the potential to do terminal damage to UK defined benefit pension schemes and to their sponsoring employers. These consequences include the social consequences of the poorer supplemental pension provision that will result as employers retreat from providing all but the minimum pension schemes for their employees. There will also be very significant economic effects. In a report commissioned by USS in conjunction with the UK's National Association of Pension Funds, Europe Economics, the highly respected and independent economic analyst, estimates that the requirement to provide additional funding to IORPs within the UK is likely to result in an impact of between 1.0% and 13.3% of Gross Domestic Product (GDP) over the first five years of any new Solvency II-style funding arrangement, as the sponsoring employers of pension schemes are obliged to direct additional funding into their pension schemes rather than into business and economic growth. It should be noted that this analysis is an assessment of the impact of simply the additional requirements to move to a risk-free measure of technical provisions.

This reduction in GDP will have an extremely damaging impact upon jobs, with an estimate from the Europe Economics analysis of between 796,000 and 2,840,000 in the period to 2023 due to the very harmful impact on company growth and prosperity.

The economic effects described above are for the UK, and whilst other countries do not have the same number or volume of defined benefit pension schemes, there would still be potentially disastrous consequences for other economies across Europe.

The draft response from EIOPA to the European Commission proposes the adoption of a holistic

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balance sheet approach to new funding arrangements, in which the 'assets' of the IORP are taken to include the value of the sponsor covenant and of any protection schemes (such as the Pension Protection Fund in the UK). We are concerned that EIOPA's draft response provides no clue as to how these mechanism would be valued and therefore, even if the holistic balance sheet proposal were acceptable as a principle (which it is not, in our view), it would be impossible to express any clear view about it beyond that first principle. EIOPA should make this known to the Commission as part of its response with a further consultation with complete information if it is intended to consider these proposals further

Despite our fundamental concerns expressed above, we have nevertheless completed appropriate sections of the draft response document, and we hope that our responses are helpful to EIOPA.

Impact assessment

This review of the IORP Directive raises complex issues and could have an impact on EU pension provision for many generations to come. It is imperative that the policy-making process is thorough and carefully considered.

USS is very concerned that the review has been allowed to develop to the current, very detailed, level without any accompanying impact assessment. Although EIOPA has now asked the *Group Consultatif Actuariel Europeen* to contribute to the impact assessment work, it appears that this work will not be concluded until relatively late in the policy-making process.

USS would suggest that impact assessment should be an integral part of the policy development process. The assessment should be drafted and expanded alongside advice on the new Directive, so that it can inform high-quality policy-making.

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	EIOPA and the European Commission should also take time to get the detail right. The current – very short – consultation period does not indicate the necessary commitment to a careful consideration of all the issues.	
1.	<p>SCOPE</p> <p>Do stakeholders agree with the analysis of the options (including the positive and negative impacts) as laid out in this advice? Are there any other impacts that should be considered?</p> <p>We recognise that the pensions landscape has changed in at least two important respects – the growth of DC pensions and the advent of funded occupational pension provision in the Central and Eastern European Member States.</p> <p>However, these changes do not automatically mean that a new Directive is required, so Option 1 (leave the Directive unchanged) must remain on the table.</p>	
2.	<p>Are there any other options that should be considered? Please provide details including where possible in respect of impact.</p> <p>No comment other than to reiterate that until an impact assessment has been carried out these proposals should not be considered further.</p>	
3.	Which option is preferable?	
4.	Are there occupational pension schemes currently falling outside the scope of the Directive, without being explicitly excluded? Are there border line cases that may need	

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	further attention?	
5.	<p>DEFINITION OF CROSS-BORDER ACTIVITY</p> <p>Do stakeholders agree with the analysis of the options (including the positive and negative impacts) as laid out in this advice?</p> <p>EIOPA's response should start by urging the EC to identify clear evidence of where the definition has obstructed cross-border pension provision.</p> <p>The response should also point out that the real barriers to cross-border pensions lie in tax and social security systems, not in pensions legislation. Furthermore, the low number of cross-border schemes does not reflect inadequate legislation; it reflects a lack of demand. Most occupational pension schemes have no ambition to provide pensions in other Member States.</p> <p>Furthermore, the additional funding requirements imposed on IORPs, that are defined benefit in nature, operating on a cross-boarder basis are unduly prohibitive.</p> <p>The EC should first conduct research to establish the <i>potential</i> number of cross-border schemes, based on the number of truly multi-national companies operating across the Internal Market. This work should recognise that many multi-nationals also operate beyond the borders of the EU.</p>	
6.	<p>RING-FENCING</p> <p>What is the view of stakeholders on the proposed principles of ring-fencing? Are the principles responding to the concerns expressed in the CfA?</p>	

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	<p>USS agrees with the EC and EIOPA on the importance of ensuring a clear and robust legal separation between sponsoring undertakings and IORPs.</p> <p>However, this protection is already provided by Article 8 of the current IORP Directive. In the UK, this legislative requirement is robustly supported by the role of the Pensions Regulator, which would intervene if a sponsoring employer were to breach these clear requirements. USS's view is that decisions on ring-fencing should continue to be left to Member States, subject to the high-level requirements of the current Article 8.</p> <p>USS does not, therefore, consider that there is a case for adding to the current IORP Directive's requirements on ring-fencing in general. We do not see that an additional statement of general principles would strengthen protection in any practical way.</p>	
7.	How do stakeholders evaluate the positive and negative impacts of the introduction of the proposed principles of ring-fencing?	
8.	What is the view of stakeholders on making ring-fencing obligatory in case of cross-border activity? Should the Member State be obliged to introduce such rules or only in the cases where investment rules are not compatible?	
9.	What is the view of stakeholders on the introduction of privilege rules? Should the Member State be obliged to introduce such rules? If not, why not ? If yes, why?	

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10.	<p>PRUDENTIAL REGULATION AND SOCIAL AND LABOUR LAW</p> <p>Do stakeholders agree with the analysis of the options as laid out in this advice, including the preference for option 2?</p>	
11.	<p>How would you assess the impact of option 2?</p>	
12.	<p>QUANTITATIVE REQUIREMENTS</p> <p>What is the view of the stakeholders on the holistic balance sheet proposal? Do stakeholders think that the distinction between Article 17(1) IORPs, 17(3) IORPs and sponsor-backed IORPs should be retained or removed?</p> <p>USS does not agree with the need to impose additional solvency requirements on IORPs as the UK already has a robust system of pension scheme funding that provides strong protection for members' benefits. The UK's 'scheme specific funding regime', thoroughly reviewed and overhauled in 2005, is now tried and tested. It helped IORPs to survive the recent financial crisis – effectively a major stress test of regulatory systems. And it is flexible enough to recognise the circumstances of individual schemes while still ensuring that members' benefits are safeguarded.</p> <p>USS sees no need to replace this framework with a new, untested system that would introduce unknown risks and uncertainties. Even if the holistic balance sheet were acceptable as a principle, which it is not in our view, it is impossible to express any clear view as EIOPA's draft response provides no detail as to how 'assets' of the IORP are taken to include the value of the sponsor covenant and of any protection schemes.</p>	-

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A report has been commissioned on behalf of the NAPF and USS by Europe Economics, a copy of which is attached. This report highlights the severely adverse economic implications of the suggested additional capital requirements and some of these implications are briefly outlined below.

Destabilising impact on scheme funding levels

Although the consultation paper gives little detail on how important components of the holistic balance sheet would be valued (eg, the sponsor covenant and pension protection guarantees), it seems almost certain that the new approach would dramatically raise funding requirements in a manner that would undermine pension provision, rather than strengthen it.

The NAPF has produced research across a sample of their member pension schemes (summarised in the graphic below) indicating that the likely switch to the use of a risk-free discount rate to value the 'best estimate of liabilities' would increase technical provisions by an average of around 27%. This equates to an *increase in technical provisions across all UK DB schemes of €337 bn.*

Additional components, such as the 'risk buffer' and 'solvency capital requirement' would drive these figures even higher. Preliminary analysis of the impact on USS shows that there would be a very substantial increase in the technical provisions of the scheme, multiplying the level of our current funding deficit.

In general, an increase in scheme funding requirements on this scale would have damaging consequences.

- *Weaker sponsor covenant.* the sponsoring employer would be placed in a weaker position, needing to find extra money to fund bigger contributions or recovery contributions into the

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pension fund. This would increase the company's insolvency risk, thereby undermining the covenant. This would be a bad outcome for the scheme's members.

- *More scheme closures and more risks for members.* The extra expense of running the company pension scheme would inevitably force more employers to reduce or cease providing pension benefits to their employees, resulting in less generous benefits for scheme members. We would see a further shift from defined benefit to defined contribution pensions, creating a system in which members have a greater exposure to risks. So a Solvency II-style regime might actually *undermine* pensions security, as well as reducing adequacy – contrary to the Commission's objectives as set out in the July 2010 Green Paper *Towards Adequate, Sustainable and Safe European Pensions Systems*.

EIOPA's proposals would also increase the complexity involved in assessing Technical Provisions, thereby increasing IORPs' actuarial costs.

Contractionary impact on EU economy

There would be a number of negative impacts on the economy that would make it more difficult for the EC to achieve the targets for job creation and investment set in the 'Europe 2020 growth strategy'.

- *Less corporate investment.* If sponsor companies have to find more money for pension contributions, then they will have less available for investment and job creation.
- *Lower company share prices / increased insolvency ratings.* The prospect of increased pension burdens on sponsoring companies would drive down their share prices and drive up their insolvency ratings.

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- *Less investment in equities.* IORPs like to match their assets to their liabilities. The use of risk-free discount rates for calculation of liabilities would incentivise IORPs to shift (even more than at present) away from investment in risk-seeking asset classes such as equities and into risk-free or low-risk assets such as government or corporate bonds. This would – again – mean less money available for equity investment in the EU economy. This effect would undermine the effectiveness of the current rounds of Quantitative Easing.
- *Lower tax take.* Impaired corporate performance would mean a lower tax take for the Government. There is also a risk that lower employment levels would drive welfare spending higher than expected.
- *Gilt yields reduced.* Although increased demand would push gilt prices up, yields would be reduced, undermining an important income stream for IORPs.

Although the holistic balance sheet would give some credit for the sponsor covenant and pension protection guarantees, the consultation paper provides no detail on how these components would be valued. In the absence of this detail, USS is unable to rely with any confidence on these components mitigating the very damaging effects of the components that would dramatically raise scheme funding requirements, such as the 'best estimate of liabilities' and the 'risk buffer'.

13.

VALUATION OF ASSETS, LIABILITIES AND TECHNICAL PROVISIONS

Do stakeholders agree that assets of IORPs should be valued on a market-consistent basis?

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	<p>EIOPA should define what 'market consistent' means in the context of the current consultation. It should not equate to the 'mark to market' approach employed in IAS19, which has undermined long-term pension provision.</p> <p>USS would suggest that 'market consistent' is best defined at Member State level by national regulators.</p>	
14.	<p>What is the stakeholders' view on the two options regarding the starting principle for valuing liabilities? Do stakeholders agree that such a principle for IORPs should contain no reference to transfer value?</p> <p>The valuation of liabilities on a market-consistent basis is inappropriate for IORPs.</p> <p>The long-term nature of IORPs means that they should be able to make long-term assumptions about valuations in order to help them to capture returns over the long term.</p> <p>The meaning of the concept of transfer value is not entirely clear from the EIOPA's draft response. It would appear that the concept is not directly applicable to the United Kingdom as, within the UK, the transfer of liabilities of an IORP to another party is extremely unlikely to take place if the scheme is underfunded. In the event that the liabilities are transferred to another party (such as an insurance company or a buy-out company), significant additional funding would be required to ensure that the IORP is fully funded on the relevant basis – referred to as the buy-out basis, which is more stringent than the on-going technical provisions basis.</p> <p>With these points in mind, USS prefers Option 1, as the UK already has a robust system of pension scheme funding that provides strong protection for members' benefits.</p>	

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15.	<p>Do stakeholders agree that the own credit standing of IORPs should not be taken into account when valuing liabilities?</p> <p>USS does not support this approach. In the context of defined benefit provision in the United Kingdom an IORP itself does not have any credit rating. The approach to valuing liabilities should be sufficiently flexible to take account of the full range of factors that have a bearing on the likelihood that liabilities will be met.</p> <p>The IORP's own credit standing is clearly an important factor in this assessment, and it should be possible for IORPs with a strong credit standing to factor this into the assumptions used for valuing liabilities.</p>	
16.	<p>What is the stakeholders' view on inserting a recital in the IORP Directive saying that supervisory valuation standards should, to the extent appropriate, be compatible with accounting standards?</p> <p>USS would strongly oppose changing valuation rules in order to establish consistency with the accounting standards for pension schemes' sponsoring organisations. Accounting standards and supervisory valuation standards for funding purposes have totally different purposes and are applicable to different institutions. Significantly, the pension scheme accounting standard (IAS 26 'Accounting and Reporting by Retirement Benefit Plans') does not require pension schemes to account for the employer's pensions obligation in their financial reports.</p> <p>IAS 19 (Employee Benefits) provides for a measure of the scheme sponsor (employer)'s liability for</p>	

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	<p>post-employment benefits at a single point of time, consistent with the employer's other assets and liabilities. The purpose of the accounting figures is to provide users of accounts with a basis for economic decisions in relation to the company.</p> <p>Accounting standards do not cater well for long-term liabilities. The use of volatile market prices to measure assets and of a 'market consistent' discount rate to measure liabilities leads to a volatility in the measurement of pension liabilities, and of scheme surpluses and deficits, that does not reflect the reality of a pensions obligation that changes only gradually over time, in line with scheme demographics. Volatility has encouraged the closure of schemes that are in reality perfectly viable, to the detriment of millions of workers who will find their incomes in retirement greatly reduced, and the adoption of inappropriate investment strategies that have increased the cost of pension provision.</p> <p>A funding valuation is intended to provide a measure of the pensions liability consistent with the assets held to provide for it. Its purpose is to provide a measure of the adequacy of the assets provide for the employer's pensions obligations as they become due.</p> <p>There is no reason why the accounting and funding valuations should be the same or even similar. Issues around accounting and funding are difficult enough without deliberately confounding the two.</p>	
17.	Do stakeholders agree with the EIOPA view to adopt Articles 76(1), (4) and (5) with appropriate amendments into a revised IORP Directive? What is the stakeholders' view on the two proposed options regarding Article 76(3)?	
18.	What is the stakeholders' view on the three options regarding the inclusion and calculation of a risk margin as introduced by Article 77?	

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	<p>USS does not accept the need for a separate risk margin.</p> <p>The concept of a separate risk margin is designed for insurance, where one-off shocks can have a major and immediate destabilising impact.</p> <p>Unlike insurance products, pensions are paid over the long term in a relatively predictable manner. IORPs respond to shocks completely differently by adjusting funding levels over the medium and long term. So it is wrong to assume that a regulatory framework designed for insurance should apply to pensions. Furthermore the UK already has a robust system of pension scheme funding, including a prudent approach to determining technical provisions, which effectively incorporates a risk margin implicitly.</p> <p>EIOPA's proposal for a risk-free approach to discounting liabilities already injects a large measure of extra prudence into the IORP funding regime. A further risk margin would pile prudence upon prudence.</p>	
19.	<p>Do stakeholders agree with the proposed conditions defining in what cases IORPs should take into account future accruals or not when establishing technical provisions?</p> <p>Our understanding of this question is that it is not about future accrual in the normal sense, rather it is about issues such as mandatory and unconditional indexation and the provision of discretionary benefits. USS agrees with option (i) that non-discretionary benefits should be included in establishing technical provisions, however, discretionary benefits should not be included.</p>	
20.	<p>Do stakeholders agree that the best estimate of IORPs should be calculated gross without deduction of amount recoverable from reinsurance contracts and special purpose vehicles?</p>	

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No comment.

21.

What is the stakeholders' view on the two options presented regarding the interest rate used to establish technical provisions (including the positive and negative impacts)?

USS is very concerned that the discussion paper presents only two options, both involving the use of risk-free interest rates. The paper should also present an option based on the *status quo*. It is unnecessary for an IORP to be prevented from taking into account the returns expected from its assets over a long-term basis as the pension promise is a long-term commitment and investment is undertaken over the long-term.

The diversity of pension schemes across the EU means that a wide range of discount rates is used. These reflect individual schemes' circumstances. It is wrong to impose a 'two sizes fit all' model.

Option 2 – risk-free discount rate

The use of a risk-free discount rate is inappropriate for long-term pension provision, not least if we wish to encourage pension schemes to invest at least partly in risk-seeking, higher return assets such as equities. It is essential for this to happen if cost-effective defined benefit pensions are to continue to be provided.

Research by the NAPF across a sample of their member pension schemes indicates that the likely switch to the use of a risk-free discount rate to value the 'best estimate of liabilities' would increase technical provisions by an average of around 27%. This equates to an *increase in technical provisions across all UK DB schemes of €337 bn.*

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	<p>Additional components, such as the 'risk buffer' and 'solvency capital requirement' would drive these figures even higher.</p> <p>As discussed elsewhere in this document, this major increase in technical provisions would have damaging effects for members, sponsoring companies and the wider economy.</p> <p>Option 3 – Level A and Level B technical provisions</p> <p>The proposal for a two-level approach to valuing technical provisions could provide a useful methodology.</p> <p>However, the consultation paper gives no detail on how the 'fixed, but not risk-free, interest rate curve' to be employed for the 'Level B' calculation is to be chosen. Instead, this is to be left to level 2 implementing measures.</p> <p>The paper also gives no explanation of how and when the two alternative measures would be used. Again, this is unacceptable – especially given the importance of the discount rate issue in pension scheme funding.</p> <p>Further detail and explanation is needed on how the risk-free rate would be determined.</p>	
22.	Do stakeholders agree that expenses incurred by the IORP in servicing accrued pension right should be taken into account in technical provisions as introduced by Article 78 of Solvency II?	
23.	Do the stakeholders agree with the analysis regarding the inclusion of unconditional,	

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	conditional and discretionary benefits in technical provisions as introduced by Article 78 of Solvency II? Do stakeholders find that discretionary benefits should be included in the best estimate of technical provisions? Is the Solvency II article on surplus funds useful for IORPs in this respect?	
24.	Do stakeholders agree with EIOPA's view of introducing Article 79 of Solvency II with appropriate amendments into a revised IORP Directive regarding allowances for financial guarantees and contractual options when establishing technical provisions?	
25.	Do stakeholders agree that it would be useful to introduce Article 80 of Solvency II with appropriate amendments into a revised IORP Directive regarding appropriate segmentation of risk groups when calculating technical provisions?	
26.	What is the view of stakeholders on the two options regarding recoverables from reinsurance contracts and special purpose vehicles as introduced by Article 81 of Solvency II?	
27.	Do stakeholders agree that it would be useful to introduce Article 82 of Solvency II with appropriate amendments into a revised IORP Directive regarding the availability of data and the use of approximations in the calculation of technical provisions?	
28.	Do stakeholders believe that it would be useful to introduce Article 83 of Solvency II with appropriate amendments into a revised IORP Directive regarding the need for assumptions to calculate technical provisions to be regularly compared against experience and adjustments made when appropriate?	

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	Article 15 already covers this issue. The proposed insertion of Article 83 from Solvency II would deliver no practical extra benefit.	
29.	<p>Do stakeholders agree that it would be useful to introduce Article 84 of Solvency II with appropriate amendments into a revised IORP Directive regarding the need for IORPs to demonstrate to the supervisor on request the appropriateness of the level of technical provisions?</p> <p>This is already covered by Article 14 of the IORP Directive. There is no need for any change.</p>	
30.	<p>Do stakeholders agree that it would be useful to introduce Article 85 of Solvency II with appropriate amendments into a revised IORP Directive regarding powers of the supervisor to require IORPs to raise the amount of technical provisions corresponding to supervisory law?</p> <p>The existing Article 14 gives national supervisory authorities wide-ranging powers to intervene when a scheme's technical provisions are unsatisfactory. Incorporating Article 85 of Solvency II would – again – deliver no new advantage.</p>	
31.	Do stakeholders agree that a new IORP Directive should allow for the Commission to adopt level 2 implementing measures regarding the calculation of technical provisions as introduced by Article 86 of Solvency II?	
32.	Do stakeholders agree that individual Member States should not be permitted to set additional rules in relation to the calculation of technical provisions as currently allowed under Article 15(5) of the IORP Directive?	

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Pension scheme funding remains a Member State competence.

USS has already argued that maximum harmonisation is inappropriate for IORPs, due to the sheer variety of pension systems across EU Member States.

We do not, therefore, accept EIOPA's argument that Article 15(5) should be removed.

This Article plays an important role in giving national-level supervisors the power to take the measures they judge necessary to ensure that their IORPs are well funded.

33.

What is the stakeholders' view on the analysis regarding sponsor support? Do stakeholders agree with EIOPA that IORPs should value all forms of sponsor support as an asset and take account of their risk-mitigating effect in the calculation of the solvency capital requirement?

If the holistic balance sheet approach was adopted (which we believe it should not be) USS agrees that that all forms of sponsor support should be treated as assets and should be seen as risk-mitigating factors.

USS is concerned about the complexity and subjectivity that would be involved in valuing the sponsor covenant, as well as significant costs incurred in undertaking such an exercise for USS which is a multi-employer pension scheme with approximately 400 sponsoring employers

We must point out that EIOPA should not be proposing a major new concept such as this Solvency Capital Requirement until it knows how the SCR would operate in practice – including the issue of how sponsor covenant would be valued.

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34.	Do the stakeholders agree that Articles 87-99 of Solvency II on own funds should be applied to IORPs? What amendments, other than the ones suggested by EIOPA, should be made?	
35.	Do stakeholders agree that subordinated loans from employers to the IORP should be explicitly allowed in a revised IORP Directive?	
36.	What is the stakeholders' view on the analysis whether to introduce or not a uniform security level for IORPs across Europe? Do the stakeholders agree with EIOPA's decision not to recommend a specific probability? If not, what specific probability should be imposed upon IORPs?	
37.	<p>Do the stakeholders agree that the confidence level should apply to a one-year time horizon?</p> <p>A confidence level is meaningless for IORPs. In addition, it would seem inappropriate to apply such short-term timeframes to IOPRs which represent a long-term arrangement or commitment. In contrast to an insurer which operates on a short-term basis (often with 12 month long contracts), pension funds operate over a long time frame. Accordingly, insurers will need to focus on their solvency over the short to medium term, whereas a pension fund can adopt a long term outlook.</p> <p>Short-termism could be very damaging for IORPs which are long-term arrangements and USS recommends that this proposal should not be taken forward.</p>	
38.	What is the stakeholders' view on applying the Solvency II-rules for calculating the	

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solvency capital requirement (SCR) to IORPs, taking into account their specific security and benefit adjustment mechanisms?

USS does not see a need for a Solvency Capital Requirement in the case of IORPs. Although we share the EC's wish to ensure robust protection for members' benefits, the assumptions on which technical provisions are calculated are already designed to provide for the risks that IORPs and their sponsoring employers face. Adding a completely new element in addition to these tried and tested arrangements would simply pile prudence upon prudence – with the consequences described earlier in this response.

USS notes that EIOPA acknowledges (in the 'negative impacts' listed after para 10.3.69) that the additional costs of the SCR could 'undermine the cost-efficiency of occupational retirement provision in the EU' and that there would be a 'risk of employers reducing occupational retirement provision (at least for future employees) in the EU'. USS shares these important concerns and urges EIOPA to emphasise its warning to the EC about these risks.

We note that EIOPA also acknowledges the 'higher' and 'completely new' costs that sponsor-backed IORPs would face in calculating the SCR.

Although the Solvency Capital Requirement would be mitigated for UK defined benefit IORPs by values assigned to the sponsor covenant and Pension Protection Fund, details of how these two components will be calculated are to be left to level 2 regulations. Without this crucial information, it is impossible to assess how the SCR system would work in practice. (There is, of course, still no impact assessment from the EC or EIOPA.) This leads us to approach the SCR proposal with great caution.

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	<p>Although the SCR will take account of the two mitigating factors identified above, it should also take account of further mitigating factors that contribute towards secure retirement incomes, including the level of pillar I (state) pensions.</p> <p>An alternative to placing a specific value on the employer covenant would be simply to take it into account when considering the robustness of recovery plans.</p> <p>USS remains of the view that the best guarantee of pensions security is to help pension schemes to be sustainable over the long term.</p> <p>Furthermore, it should be noted that benefit adjustment mechanisms vary between individual member states. In the United Kingdom mechanisms such as conditional indexation or reduction of accrued benefits do not exist. Accordingly, there is no mechanism to mitigate the impact of any additional funding requirements on the IORP through such easements. This could potentially result in a significant number of sponsoring employers having no option but to cease future accrual of defined benefits under the IORP that they sponsor.</p>	
39.	<p>Do the stakeholders believe that IORPs should assess the SCR on an annual or three-yearly basis?</p> <p>As explained in answer to Q38 above, USS's strong preference is not to impose the SCR at all.</p> <p>In any event, we believe that a one-year time horizon is totally inappropriate for IORPs. The core purpose of an IORP, as opposed to individual forms of provision, is to provide benefits that are equitable across generations by diversifying risks over membership and time. Measuring the performance of an IORP over a one-year horizon would rob it of the ability to carry out this function.</p>	

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40.	<p>What is the stakeholders' view on imposing a minimum capital requirement (MCR) upon IORPs? What adjustments to the Solvency II rules are needed regarding the structure and frequency of the calculation?</p> <p>USS is opposed (as explained in Q38) to the SCR. And without an SCR, there is, of course, no need for an MCR either. USS is, therefore, opposed to both.</p>	
41.	<p>What is the stakeholders' view on the analysis regarding pension protection schemes? If included in the holistic balance sheet, should pension protection schemes be taken into account by reducing the sponsor's insolvency risk or by valuing it as a separate asset?</p> <p>USS does not accept the case for the holistic balance sheet. But, if the EC decides to take the proposal forwards, then it should certainly recognise the role of pension protection schemes.</p> <p>USS would argue, in fact, that the existence of the sponsor covenant and Pension Protection Fund in the UK, together with other security mechanisms such as governance arrangements and the role of the Pensions Regulator, means that there is no need for an extra element in the form of a SCR.</p>	
42.	<p>Do stakeholders agree that capital requirements for operational risk should be applied to DC schemes where investment risk is borne by plan members? Should these capital requirements be uniform or tailored to the actual risk profile? Do stakeholders find it sensible to distinguish between DC and other schemes in the area of operational risk?</p>	
43.	<p>What is the stakeholders' view on the analysis regarding the duties of IORPs and the powers of supervisors in the case of deteriorating financial conditions as introduced by</p>	

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	<p>Article 136 and 141 of Solvency II?</p> <p>USS agrees that IORPs should continually monitor their financial position and notify significant deteriorations (and how they intend to address them) to the supervisory authorities.</p> <p>However, these requirements are already adequately covered by Article 16.1 of the IORP Directive and by the 'Prudent Person Principle'. There is no need to import sections of Solvency II in order to cover this point.</p>	
44.	<p>What is the stakeholders' view on the analysis regarding the submission of recovery plans and the length of recovery periods as introduced by Articles 138 and 139 of Solvency II? Should the recovery periods – with regard to the SCR and possibly the MCR – for IORPs be flexible, fixed or a combination of both? What would be the reasons – if any – to allow IORPs longer recovery periods than prescribed by Solvency II?</p> <p>USS favours option one – retain the current flexible position on recovery periods.</p> <p>Allowing IORPs to have longer recovery periods than insurance companies recognises the distinctive nature of pensions, which are paid out over the long-term in a largely predictable manner. It also recognises that, as long-term institutions, IORPs should be allowed to 'ride out' periods of poor economic and investment performance in the expectation that the resulting deficits will be eliminated as conditions improve over the medium term.</p> <p>It is, of course, essential that recovery periods are approved by the national supervisor.</p> <p>USS is concerned that EIOPA's advice (at para 10.3.194) appears to envisage restricting recovery</p>	

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	<p>periods that bring IORPs back to the MCR level – (effectively the same as technical provisions) to a shorter timeframe than the 15 years mentioned in para 10.3.190. This would massively restrict sponsors' flexibility and would increase the risk of accelerated DB scheme closures explained in our answer to Q12 above.</p> <p>However, USS notes that EIOPA's advice on these points is unclear. This is a key area in which further consideration and explanation is required. One point to consider is that defined benefit schemes in the United Kingdom having on-going support in the form of the covenant provided by their sponsoring employers and this should be taken into account when reviewing recovery periods. It would be unwise to introduce a system of recovery plans that results in unfair and unrealistic pension costs crippling sponsoring employers with the result that such sponsors have no option but to cease future accrual of defined benefits under the IORP that they sponsor.</p>	
45.	<p>Do stakeholders agree that the IORP Directive should be extended with stipulations introduced by Article 137 and 140 allowing supervisors to prohibit the free disposal of assets when IORPs do not comply with the capital requirements or the rules for establishing technical provisions?</p>	
46.	<p>Do stakeholders agree that it should be specified in the IORP Directive what constitutes a recovery plan as introduced by Article 142 of Solvency II? How should the contents differ from those of insurance companies?</p> <p>Article 142 is not appropriate for IORPs. Key parts of Article 142's requirements, such as estimates of management expenses and estimates of income and expenditure in respect of direct business, are not relevant for IORPs.</p>	

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	Recovery plans should be based on projections for future years, showing the IORP's financial position, including benefits to be paid and expected contributions and returns. The recovery plan should also include the contribution policy and the indexation policy.	
47.	<p>INVESTMENT RULES</p> <p>Do stakeholders believe that the prudent person principle is a sufficient basis for the investment of IORPs or is additional provision needed?</p> <p>USS agrees that the prudent person principle is a good protection for IORP investments, and this is well covered in the existing IORP Directive text.</p> <p>We do not object in principle to EIOPA's proposed amendments, which are already covered by the prudent person principle, but it is not clear that they would deliver any practical increase in protection.</p>	
48.	<p>Do stakeholders feel that Member States should have the option to impose limitations on investments in addition to those set out in the IORP Directive? What about host member states?</p> <p>USS agrees with EIOPA's advice that there is no need for a special investment restriction in these circumstances.</p> <p>In the UK, the regulatory regime for IORP investment in the plan sponsor has recently been revised to ensure it remains robust.</p>	

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	These issues should be subject to the 'Prudent Person Principle'.	
49.	<p>To what extent do stakeholders believe the investment provisions of the Directive should differ between defined benefit and defined contribution pensions?</p> <p>No comment.</p>	
50.	<p>Do stakeholders agree with the analysis of the options (including the pros and cons) as laid out in this advice? Are there any other impacts that should be considered?</p> <p>As in the previous answer, the prudent person principle is the key to securing good investment outcomes.</p>	
51.	<p>What is stakeholders' view of the current prohibition on borrowing in Article 18(2)?</p> <p>UK IORPs are already barred from borrowing.</p>	
52.	<p>OBJECTIVES AND PRO-CYCLICALITY</p> <p>What is the stakeholders' view on the analysis regarding the objective of supervision and the measures to avoid pro-cyclical behaviour?</p> <p>USS would urge EIOPA to take its advice to the next level by asking the EC to conduct an impact assessment to assess whether the proposed new IORP Directive would have a pro or counter-cyclical impact on the EU economy.</p>	

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	USS favours leaving the IORP Directive unchanged in this respect.	
53.	<p>GENERAL PRINCIPLES OF SUPERVISION, SCOPE AND TRANSPARENCY AND ACCOUNTABILITY</p> <p>Do stakeholders agree with the principle that the material elements of the Solvency II requirements in respect of the general principles of supervision, and in relation to transparency and accountability should also apply to IORPs?</p> <p>USS agrees that Articles 29 and 31 of Solvency II could usefully be incorporated into the IORP Directive. However, the IORP Directive should continue to provide flexibility for national regulators to set rules that take account of the particular circumstances of their own pension systems.</p>	
54.	<p>Has EIOPA identified correctly those issues – need to enhance benefit security, differences between IORP and insurance supervision, and diversity of IORPs - where there should be differences between insurers and IORPs on supervision and transparency and accountability?</p> <p>USS agrees that these are key differences between IORPs and insurers.</p> <p>Further significant differences include the involvement of social partners in pension provision (for example through trade union representatives serving as member-nominated trustees), the role of trustees in general, and – crucially – the close involvement and support of the employer as sponsor of the scheme. So pension funds have extensive and legally binding commitments from their providers of funds.</p>	

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Unlike insurance companies, IORPs are run on a not-for-profit basis. Furthermore, the Types of risk covered are fundamentally different. Insurers can cover the possibility of catastrophic and unpredictable events (for example, a natural disaster such as a flood or hurricane) whereas a pension fund aims to provide an individual with income in retirement (covering risks such as longevity, salary increases, and poor investment performance). As such the insurer could be exposed to significant, one off claims at any point in time from a large number of policy holders so will need to have sufficient capital to cover this.

Work-based pension funds are social protection vehicles, not financial services enterprises. Unlike insurers and other financial institutions, they do not compete with each other to offer pensions to the public at large.

There is a great diversity of pensions systems across Europe. Unlike other financial institutions whose 'products' are much more homogeneous (such as banks and insurance companies), work-based pensions vary considerably across Member States. The tax rules that shape pension provision is also set at member state level. These factors make a 'one-size-fits-all' solution to security impossible to deliver. Moreover, the diversity of EU pension systems should be seen as strength - one that has helped insulate both pension systems and national economies from systemic risk. So the objective should be to develop a system that is flexible enough to deliver effective security for scheme members in each Member State, rather than to attempt to harmonise pension systems across the EU.

55.

GENERAL SUPERVISORY POWERS

Do stakeholders agree with the recommendation that supervisory authorities should have broadly the same powers to require IORPs to conduct stress tests as it has in respect of

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	<p>insurers?</p> <p>USS is not opposed in principle to giving EIOPA and national regulators powers to conduct stress tests of IORPs. However, it is vital that these tests do not add a major additional administrative or cost burden.</p> <p>USS urges EIOPA to conduct an impact assessment on this measure before including it in its final advice to the EC.</p>	
56.	Do stakeholders agree with reinforcing the sanctions regime for IORPs?	
57.	Should knowledge of the imposition of penalties be public or restricted?	
58.	Should host states be able to impose sanctions on IORPs without going through the home state?	
59.	<p>SUPERVISORY REVIEW PROCESS AND CAPITAL ADD-ONS</p> <p>What is the view of stakeholders on whether the requirements for the supervisory review process for insurers should also apply to IORPs?</p> <p>USS favours Option 3: allow Member State to determine the most suitable approaches to supervision for their IORPs.</p> <p>Many Member States, including the UK, already have robust regulatory oversight in place, supported by the existing Articles 13 and 14 of the IORP Directive.</p>	

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	As explained throughout this response, Solvency II is the wrong starting point for initiatives to strengthen the security of pensions.	
60.	<p>What is the view of stakeholders on whether the requirements for capital add ons for insurers should also apply to IORPs?</p> <p>It would be inappropriate to impose capital add-on requirements on IORPs similar to those applicable to insurers.</p>	
61.	<p>SUPERVISION OF OUTSOURCED FUNCTIONS AND ACTIVITIES</p> <p>Do stakeholders agree that the material elements of the requirements on insurers in respect of supervision of outsourcing should apply also to IORPs?</p>	
62.	<p>What is the stakeholders` view on proposed changes to the definition of home state and rules on chain outsourcing?</p>	
63.	<p>GOVERNANCE</p> <p>Do stakeholders agree with the principle that the material elements of the Solvency II requirements for governance apply to IORPs, subject to proportionality?</p> <p>USS agrees that the governance elements of Solvency II could reasonably be used as a basis for a new section of the IORP Directive. High standards of governance are vital for good retirement provision.</p>	

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	<p>Although USS strongly opposes the translation of Pillar I of Solvency II into the IORP Directive, we recognise that provisions from Pillars II and II could usefully be imported in order to strengthen protection for scheme members.</p> <p>Any new governance clause must allow for flexibility; the diversity of pension and governance systems at national level should be seen as a strength for the EU, not as a weakness. So the new IORP Directive should set high-level requirements for governance, allowing national supervisors to set detailed standards at Member State level.</p> <p>EIOPA should also point out that governance requirements must not impose burdensome requirements on IORPs. As EIOPA states at section 10.3.4, "A new supervisory system for IORPs shall not undermine the supply or the cost efficiency of occupational retirement provision in the EU"¹. This is a further reason for a detailed impact assessment, which should take particular account of the potential impact on small pension schemes.</p>	
64.	Has EIOPA identified correctly the areas such as member participation and remuneration policy where there should be differences between insurers and IORPs on general governance requirements?	
65.	FIT AND PROPER Do stakeholders agree the introduction of the same fit and proper requirements for IORPs as were introduced for insurance and reinsurance undertakings in article 42 (1) of the	

¹ EIOPA, Draft response to the Call for Advice on the Review of the Directive 2003/41/EC, EIOPA-CP-11/001, p. 43

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Solvency II Framework Directive?

USS disagrees with EIOPA's draft recommendation that the 'fit and proper' definition in Article 42 of Solvency II should be copied across into the IORP Directive.

Article 42's requirement for 'professional qualifications' fails to take account of the approach to governance in the UK, where lay trustees play a major – and very effective – role in ensuring that members' interests are well protected. The UK's Pensions Act 2004 requires trustees to have knowledge and understanding of the law relating to pensions and trusts and the principles of funding and investment. They are also expected to be familiar with the scheme's deed, rules and other documents.

Article 42 would also fail to recognise the effective contribution to good pension scheme governance made by the Myners Principles for Occupational Pension Schemes, first published in the UK in 2001, which set a widely respected benchmark for good governance. The first principle, on 'Effective decision-making', is as follows:

'Decisions should be taken only by persons or organisations with the skills, information and resources necessary to take them effectively. Where trustees elect to take investment decisions, they must have sufficient expertise and appropriate training to be able to evaluate critically any advice they take.

'Trustees should ensure that they have sufficient in-house staff to support them in their investment responsibilities. Trustees should also be paid, unless there are specific reasons to the contrary.

'It is good practice for trustee boards to have an investment sub-committee to provide the

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	<p>appropriate focus.</p> <p>'Trustees should assess whether they have the right set of skills, both individually and collectively, and the right structures and processes to carry out their role effectively. They should draw up a forward-looking business plan.</p> <p>'We recognise that it is important to ensure all trustees have the necessary skills and knowledge, and this is why the NAPF runs training courses for trustees and strongly supports the Pensions Regulator's requirements on Trustee Knowledge and Understanding (TKU).'</p>	
66.	<p>Do stakeholders agree with the advice that:</p> <p>a. The fit and proper requirements should apply at all times</p> <p>b. There should be effective procedures and controls to enable supervisory authorities to assess fitness and propriety</p> <p>USS agrees that fit and proper requirements should apply at all times and that there should be procedures and controls to enable supervisory authorities to assess fitness and propriety.</p>	
67.	<p>What powers should supervisory authorities have in the event that the fit and/or proper requirements are not fulfilled?</p> <p>National supervisors should be allowed to decide on the best approach to assessing the fitness and probity of IORP trustees.</p>	
68.	RISK MANAGEMENT	

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	What is the view of stakeholders on the proposed principles of the revised IORP directive? How do stakeholders evaluate the positive and negative impact of the proposed risk management principles?	
69.	OWN RISK AND SOLVENCY ASSESSMENT Do you agree with EIOPA that ORSA is, in principle, suitable for IORPs? Please provide evidence/reasons supporting your view.	
70.	What should be the scope of ORSA for IORPs where members bear all the risks? How do you assess the impact of introducing ORSA?	
71.	What is the stakeholders' view of the necessity to perform ORSA in the event that the holistic balance sheet approach is adopted?	
72.	INTERNAL CONTROLS What is the view of the stakeholders on the proposed new explanatory text on the whistle-blowing obligation of the compliance function? USS agrees that Member States should have the option to introduce whistle-blowing obligations as part of the compliance regime. This principle is already enshrined in the UK's Pensions Act 1995.	
73.	What is the view of the stakeholders on the proposed new explanatory text on the scope (the fact that the compliance function should include all legislation with an impact on the operations of an IORP)?	

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74.	INTERNAL AUDIT Do stakeholders agree that the material requirements of internal audit in respect of insurers should also apply to IORPs, subject to proportionality and other changes?	
75.	What is the view of stakeholders on the proposed whistle-blowing obligation of the internal audit function?	
76.	ACTUARIAL FUNCTION What is the view of the stakeholders on the role and duties of the actuarial function of IORPs?	
77.	Are the requirements of Solvency II the correct starting point for the actuarial function?	
78.	Do you agree with the importance of independence of the actuarial function? What do stakeholders perceive as the necessary criteria for the independence of the actuarial function?	
79.	Do stakeholders agree with the analysis of the options (including the pros and cons) as laid out in this advice? Are there any other impacts that should be considered?	
80.	OUTSOURCING Do stakeholders agree that the material requirements on insurers in respect of outsourcing should also apply to IORPs?	

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81.	Do stakeholders agree with the standardisation of outsourcing process in order to enlarge the cross-border activity?	
82.	What are the minum outsourcing contract elements stakeholders consider as useful to ensure the protection for IORP members and beneficiaries?	
83.	CUSTODIAN / DEPOSITARY What is the view of the stakeholders on the proposed treatment of depositaries?	
84.	How do stakeholders evaluate the positive and negative impacts of the proposals?	
85.	What do stakeholders anticipate in terms of cost and other consequences of the implementation of a compulsory regime regarding the appointment of a depositary under options 2 and 3 for: (a) the safe-keeping of assets; (b) oversight functions?	
86.	What do stakeholders anticipate in terms of cost and other consequences of the implementation of the general requirements regarding: (a) the need for a written contract; (b) the role of a depositary in terms of safe-keeping; (c) the liability regime of depositaries; (d) the list of minimum oversight functions that should be perform; (e) conflict of interest?	
87.	Do stakeholders agree that the list of minimum oversight functions that should be performed by a depositary is appropriate?	
88.	What do stakeholders anticipate in terms of cost and other consequences of the	

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	implementation of the general requirements that should be verified in case a depositary is not appointed?	
89.	INFORMATION TO SUPERVISORS Do stakeholders agree with the analysis of the options (including the pros and cons) as laid out in this advice? Are there any other impacts that should be considered? USS notes sub-paragraphs 28.3.6 and 28.3.7 of EIOPA’s draft response in which it is confirmed that there are genuine reasons for the large differences across member states in terms of the information collected by supervisors. This can be due to different types of pension arrangements, differences in legal form, etc. On this basis, option 1 would seem to be the most appropriate approach allowing flexibility for supervisors to determine their information requirements rather than requesting what could be unnecessary information for IORPs, that incur an increase in costs and resources as a result.	
90.	Would stakeholders welcome convergence of provision of information to supervisors: (i) completely; (ii) in certain fields; (iii) not at all.	
91.	INFORMATION TO MEMBERS / BENEFICIARIES Do stakeholders believe that additional information requirements - besides the current ones - are not only necessary for DC schemes, but also for DB schemes? Additional information requirements for DB schemes could help to improve communications with members. Some high-level EU standards could provide a useful foundation.	

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	<p>However, it will be important to take account of the specificities of DB pensions and their differences from DC. Any standards must also allow flexibility for national supervisors to implement them flexibly in each Member State.</p> <p>In addition it should be remembered that scheme members in the context of a defined benefit IORP are not strictly a customer unlike an insurance policyholder or personal pension plan holder.</p>	
92.	Are stakeholders happy with the potential introduction of a KIID-like document for DC schemes and with its contents as envisaged in the draft EIOPA advice? In particular are stakeholders happy with the introduction of a document (KID) that would contain information beyond investment? How important it is that this document facilitates comparisons between IORPs?	
93.	How would stakeholders suggest communicating in the KID the risk/reward profile and/or the time horizon of different investment options? Do they think that the risk ranking should be the same for all time horizons, or should vary with time horizons, allowing for a more favourable ranking of equity-oriented investment options for long horizons? How should performance scenarios be conceived? Should they vary for different asset allocations, allowing for a risk premium for equity-oriented investment options? What a reasonable measure of the risk premium would be?	
94.	Are stakeholders happy with the introduction of a personalised annual statement to be delivered to each member? Whether and how should it contain information on costs actually levied, and how should it be coordinated with the ex-ante information on costs to be included in the KID?	

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95.	<p>What is the view of stakeholders as regards the level of harmonisation of information requirements that can be reasonably achieved with the revised IORP directive? Besides those envisaged by the EIOPA advice, are there other parts of the regulation that should be harmonized?</p>	
96.	<p>Do stakeholders agree with the impact assessment of the EIOPA proposals?</p> <p>As mentioned in sub-paragraph 2.7.3, it is acknowledged that the impact assessment contained in each Call for Advice is preliminary and more research is required. USS reiterates the position outlined in question 1, that is a thorough and in-depth assessment should be an integral part of the consultation process.</p>	