	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:	prof.dr. A.A.J. Pelsser HonFIA, Netspar & Maastricht University, Netherlands	
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	The question numbers below correspond to Consultation Paper No. 06 (EIOPA-CP-11/006). **Please follow the instructions for filling in the template:** ⇨ Do **not** change the numbering in column "Question". ⇨ Please fill in your comment in the relevant row. If you have no comment on a question, keep the row empty. ⇨ 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. o 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. o 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*, in MSWord Format, (our IT tool does not allow processing of any other formats).**	
Question	**Comment**	
General comment		

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1.	Yes, we largely agree with the analysis. However, we recommend a different redefinition of the scope. (For an elaborate impact analysis, we refer to Chapter 3 of the attached Netspar Design Paper.)	
2.	We propose the following adjustment of the scope of the IORP directive. 1) Book reserves and pay-as-you-go-schemes: The current exemptions in the IORP Directive for bookreserve schemes and pay-as-you-go schemes could be abolished. Including book reserve and pay-as-you-go schemes within the scope of a revised IORP Directive does not necessarily imply that such schemes are required to build up reserves. The ability to raise future contributions – in combination with the absence of insolvency risk (for example in case of industry-wide schemes) or possibly backed up by insolvency protection – may be regarded as an asset. Hence, the funding requirements in Article 16 of the IORP Directive do not need to be applied. 2) Small pension institutions: A second adjustment of the IORP scope could be realized by deleting the option (in Article 5 of) the IORP Directive for Member States not to apply this directive to small pension institutions. Exercise of this option by Member States can lead to a breach of the goal of equal protection of plan members and beneficiaries of occupational pension schemes. Supervision based on the provisions of the IORP Directive could turn out to be too heavy for small pension funds given their size, so that it could force such funds to wind themselves up. Such consequences might be avoided by the introduction of an option for small pension institutions for a kind of "simplified supervision". 3) Pension schemes in new Member States: The IORP scope should also be modified by expanding its application to pension schemes which are currently not covered by the IORP Directive. A first modification of the scope to include these schemes would be to add a reference to them on the basis of a legal obligation in the definition of "institution for occupational retirement provision" in Article 6 of the IORP Directive. Such addition would cover existing schemes (primarily in the new Member States), where the provision of retirement benefits in the context of occupational activities is not based on an agreement or contract between employers and employees but on a legal obligation (see	

	EIOPA, 2011, Par. 6.3.12). In addition to such amendment, the scope of the IORP Directive should in general be redefined to cover occupational pension institutions that operate collective pension schemes and in which all biometric and investment risks are economically borne by employers and/or (present or future) scheme members and beneficiaries. Such a redefinition has is very similar to one of the suggestions from EIOPA (2011, Par. 6.3, Option 4), namely the option to place under the IORP Directive all occupational pension providers that are neither covered by an EU prudential regulation nor guaranteed by a public authority, even when classified as social security schemes (for example in case of a classification as 1st or 2nd pillar). The redefinition proposed by us, would prevent other institutions than occupational pension funds from falling under the IORP Directive, such as insurance companies and retail investment funds.	
3.	None of the options proposed by EIOPA, but the redefinition proposed by us under 2.	
4.	Yes, see 2.	
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12.	The aim of the holistic approach is to achieve a comparable supervision tool by permitting different security mechanisms across member states. This method has several clear advantages both for the pension fund itself and for the supervisor that has to assess the financial health of the pension fund. o It considers all possible security mechanisms as forms of solvency. Intuitively, a pension scheme with sponsor backing in case of shortfalls offers beneficiaries higher protection than an otherwise	

	identical pension fund without such a backing. If part of the required protection can be provided for by the sponsor, the protection through own funds can be lower compared to a situation without sponsor support. o Different pension funds, and theoretically even different pension schemes (i.e. even unfunded schemes), can be compared and assessed based on their overall solvency position. This could enhance transparency and comparability for beneficiaries. However, applying the holistic approach in practice also offers challenges: o Valuation is usually not straightforward. It may not be easy to derive analytical formulas that can provide an unambiguous value of the security mechanism. Even by using simulation techniques, the method and techniques are time and resource intensive, making it more difficult for smaller pension schemes to apply it. Proportionality is obviously an issue here. o The method involves an assessment of many non-observable and non-tradable variables including sponsor credit risk and the correlation between the financial positions of both the pension fund and the sponsor. Due to the uncertainty surrounding the 'true' value of a measure in the holistic balance sheet approach, only a range of outcomes can be reliably determined. As a final note: we believe the distinction between the IORP's should be removed. These are merely "different shades of grey" in the holistic balance sheet approach.	
13.	Yes, value assets on a market-consistent basis.	
14.	Choose option 2: Amend the current IORP Directive to state that the valuation of technical provisions should be done on a market-consistent basis.	
15.	Agree: own credit standing should not be taken into account to value liabilities. Certainly not by increasing the discount rate! Note: in the holistic balance sheet approach, the option to reduce the	

	benefits is an asset with a positive value, and should be reported as such. In this way, the "credit standing" can be made explicitly visible in the balance sheet.	
16.	Agree.	
17.	Agree to adopt 76(1), (4) and (5). Choose option 2: require IORPs to calculate their technical provisions on a market consistent basis.	
18.	Choose option 2: Explicit risk margin in technical provisions calculated according to Solvency II.	
19.	Agree. The definining distinction should be if the contributions are *mandatory* (then they can be included in the calculation) or *voluntary* (then they cannot be included in the calculation).	
20.	Agree. Deductions should be made visible separately in the balance sheet.	
21.	Unfortunately, there seems to be a lot of confusion on the "correct" calculation of market-consistent values. The source of confusion seems to be, that there are multiple calculation methods which all lead to the same (correct) answer. Let us consider the example of pension liabilities with conditional indexation. One calculation method starts with identifying nominal guaranteed cash flows, these should be discounted with the nominal risk-free term-structure of interest rates. Then, conditional indexation is values separately as additional options. Another calculation method starts with identifying fully indexed (i.e. real) cash flows. These need to be discounted with the term-structuer of real interest rates. Then the option to pay less that 100% indexation is valued separately. If implemented correctly, both calculations lead to the same market-consistent value of the conditional indexation. Our advice: do not add to the confusion by imposing a discount curve, but make sure that IORP's perform a correct market-consistent calculation. This is already covered by: "*Member States shall ensure that IORPs value their liabilities on a market consistent basis*"	
22.	Yes, expenses should be included	
23.	Yes & Yes: all types of benefits should be included in the calculation.	
24.	Yes, introduce Acritcle 79.	
25.	Choose Option 2: Article 15 of the IORP is sufficient	
26.	Choose Option 1**:** Not to include Article 81	
27.	Agree	

28.	Agree	
29.	Agree: this is very important for the supervisor to have this power!	
30.	Agree.	
31.	Agree	
32.	Do not agree. Member states should retain the possibility to lay down more detailed rules for the calculation of technical provisions.	
33.	Agree. However, the calculation should take the credit-position of the sponsor into account at times when the sponsor needs to make additional payments. As we have seen in the recent crises: sponsors are typically facing hard times at exactly the same moment when the pension fund is doing badly. Hence the "sponsor support option" may have a significantly lower value than a "simple" call-option calculation might suggest.	
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36.	No need to introduce a uniform confidence level. There is such a wide range of pension plans, that a uniform confidence level adds little in terms of improved harmonisation. Only for a pure DB with "rock solid" guarantees would it make sense to insist on a confidence level of 99.5% (equal to Solvency II). On the other extreme, for a pure DC a confidence of x% has little meaning, as all the risks are borne by the plan members.	
37.	Do not agree. The solvency of pension funds should be assessed over a combination of short, medium and long-term horizons, as different generations share risks within the pension fund. We propose the following instruments: capital requirements, the continuity analysis, stress testing, and recovery plans. * **Capital requirements**: Capital requirements resembling the Minimum Capital Requirement (MCR) and the Solvency Capital Requirement (SCR) are the most well known examples of minimum requirements. We will refer to these capital requirements as MCR and SCR, because of the widespread acceptance of the terms. Breaching these requirements automatically triggers supervisory actions such as recovery plans. The calculation of the SCR is often based on a short term	

	Value-at-Risk measure. Typically the capital requirement is defined as the amount of capital required in order to withstand 1-year scenarios with a certain probability. * **Continuity analysis**: Next to these short term requirements, long term minimum requirements can also be of use. The continuity analysis can be used to assess the possible evolution of the pension fund's financial position against the background of realistic long-term economic scenarios. Key to the continuity analysis is that the impact of security mechanisms such as for example the indexation policy and contribution policy can be fully taken into account. Based on a set of assumptions, it is possible to assess whether the pension fund will be able to reach or stay above a certain funding level if normal operating conditions prevail. There is added value to use continuity analyses in addition to capital requirements. A pension fund that is currently better funded than the capital requirement can fail for the continuity analysis if preset policies (i.e. indexation or profit sharing) are too lenient. Continuity analyses can be especially useful to assess and develop recovery plans. Also, it should be noted that continuity analyses can also be very useful for DC plans and pay-as-you-go schemes. Even though there is no defined benefit to be monitored, it can be assumed that participants of a DC scheme have expectations regarding the expected pension benefit (accrued wealth or periodic annuity payment). Providing the information regarding expected outcome enables participants to check this against their expectations. For the supervisor, it can be useful input to check the actual situation against the communication. A continuity analysis is an important building block in regulating pension funds with long term commitments and long term investment strategies. It allows pension funds to gain grip on their dynamics in a situation fraught with uncertainty (DNB, 2007). The continuity analysis thus contributes to the assessment of a sustainable financial prospect for the pension fund and as a result, to the protection of beneficiaries' interests in both DB and DC schemes. The continuity analysis is strongly related to the common practice in the pension fund industry of Asset-Liability Management studies and has become increasingly important (De Jong and Pelsser, 2010). * **Stress testing**: Stress testing provides insight into the risks faced by the IORP when adverse	

	financial developments suddenly affect the capital. Stress tests can be carried out on a short horizon to gain insight in worst case investment scenarios. For risks that can never materialize on a short term horizon such as deflation, inflation or longevity risk, long term stress tests can equally prove of value. A stress test verifies to what extend the pension fund is continuously able to meet its liabilities despite a period of distress, taking into account offsetting measures. Such stress tests do not necessarily need to have the same status as a capital requirement: falling below a certain predefined minimum capital or funding ratio within the results of a stress test can however provide insight in the risks of the pension fund because modelling difficulties are avoided. A raised flag because of a stress test result can at the very least trigger discussion between the fund and the supervisor regarding the strategy. Furthermore, it can be used in assessing whether the communication to participants about the realistic expected benefits is adequate. This is again equally true for DC and pay-as-you-go schemes. * **Recovery plans**: Once a pension fund is underfunded, it becomes increasingly important to monitor the road to recovery and the effectiveness of measures taken. At initiation, a recovery plan is an important instrument for the supervisor to review and discuss the measures of a pension fund to recover. Going further, the actual situation can be compared to the expected recovery path. Given the known risk profile of the pension fund, a supervisor could even develop internal trigger points to act as a first warning for escalation of the recovery plan.	
38.	Agree.	
39.	See response to 37.	
40.	See response to 37.	
41.	Not much difference between option 1) and2) as long as the value of the PPS is reflected. Note that introducing a PPS, introduces (patially) PAYGO elements into funded pension schemes: in case of failure society pays the bill, in a very similar way to a PAYGO system.	
42.	All risks should be included in a risk assessment. See also response to 37.	
43.	Agree. See also response to 37.	

44.	Option 3. See also response to 37. (Recovery plan)	
45.	Agree. See also response to 37.	
46.	Agree. See also response to 37.	
47.	Option 3 (allow for outsourcing)	
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52.	We believe it would be very helpful if EIOPA states explicitly what the key objective of pension fund supervision is. We propose: "*To make sure that reasonable policyholders expectations are being fulfilled by the pension fund.*" From this key objective follows that the key focus of pension fund supervision should be: "*To what extent are the contribution policy, investment policy, sponsor commitments, and funding position of the pension fund in line with the benefits and risks communicated to all stakeholders in the pension fund?*" Avoiding the triggering of pro-cyclical behaviour is indeed important for supervisiors. This should be done in the form of recovery plans (See also response to 37.) Using "equity dampers" and/or "duration dampers" is the **wrong** way to avoid procyclical behaviour, as this deals with the symptom only ("stop calculating risk numbers and hope for the problem to go away") and not with the underlying problem (deal with the underfunding situation of the pension fund).	
53.	Agree	
54.	We find that the current proposals focus very strongly on quantitative supervisiory instruments. Quantitative requirements have the advantage of simplifying supervision, since most red flags are unambiguously based on objective data. However, a risk of using quantitative requirements only is that the reporting framework is too restrictive to adequately reflect the specific situation of a pension fund. Most supervisory regimes therefore complement the quantitative instruments with qualitative instruments. An underpinning of the specificities of the IORP in order to mitigate supervisory actions	

	is usually possible. The specific situation of a pension fund may be further identified using qualitative instruments. As mentioned, qualitative instruments may require more subjective judgment and interpretation than quantitative instruments the available to the supervisor. We identify the following qualitative instruments: the checklist, the self assessment, document sharing and disclosure requirements. * **Checklist:** With a broader use than mechanically checking the financial health of an IORP, a checklist approach can be a simple and effective way to quickly overview important elements. Especially for a supervisor, it is a good way to quickly overview a large amount of pension funds to gain insight in the overall status of the entire sector. Checklists are also suitable to cover governance, communication and risk management elements. Without further detail, 'yes or no' questions can be the first stage before giving rise to additional information or discussion. * **Self Assessment**: (see also our responses to CfA 16) The most common principle based instrument for supervisors is to ask IORPs to periodically submit a self assessment for a specific area of management. An insightful example can be taken from the insurance sector, where insurers are periodically required to submit an Own Risk and Solvency Assessment. The ORSA is 'free form': an insurer has to show that appropriate risk controls are in place, regularly updated and are an integral part of the day to day business. An ORSA for IORPs would be adequate in reporting about non-standard situations since the way of reporting is left free. * **Document Sharing**: At first sight it might not seem an actual instrument for supervision, but many principles can easily be monitored by simply providing existing documentation: annual reports, websites or newsletters can be an important source for the pension funds to show how their communication policy works out in practice and whether it adheres to the desired standard. Since documentation is non-standardized, a qualitative approach needs to be followed. * **Disclosure Requirements**: Communication to participants is increasingly being recognized as an important factor to retain broad support for the pension sector, especially since financial and demographic developments have put pressure on pension agreements. Rules based requirements can ask all IORPs to periodically provide certain overviews to its participants, to provide more transparency in policy or policy adjustments or to communicate about relevant developments in the sector. As an illustration, Dutch pension funds are required to provide participants at least annually with an overview of their expected benefit at retirement. Also, specific communication requirements have been developed to provide information	

	about the quality of the indexation policy.	
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68.	Agree. We would like to add the following note to EIOPA's analysis. Risk-management should be tailor-made for the pension scheme under consideration. At the two extremes of the scale we identify: • DB pension schemes with a "hard" guarantee. We believe that for pension benefits with hard guarantees where no ex-ante possibility of lowering the benefits exists, the supervision should focus on ensuring that the guarantees promised to the participants can be realistically met. [This is very well covered in the proposed text by EIOPA] • At the other extreme we find individual DC schemes. Here the supervision should focus heavily on the communication of the scheme to the participants. Are the participants fully aware of the risks they are running and the expected benefit in relation to their expectations? Are the participants	

	currently saving enough, to obtain a sufficient level of retirement benefits? [Here we would like to draw EIOPA's attention to the "communication part" as opposed to the "hard-core" Value@Risk approach.]	
69.	Yes, we agree that ORSA is suitable for IORP's. We offer the following reasons: The ORSA is not intended to compute capital requirements, but it must be an integral part of the business strategy and must be taken into account on an ongoing basis in the strategic decisions of the insurer. ORSA may also serve as a useful tool for pension funds as it will strengthen the understanding of risk sources, encourages a professional risk management culture and creates confidence amongst all stakeholders in the viability of the pension funds financial policy. As ORSA is a dynamic forward-looking risk management tool, it naturally connects to the profile of pension funds.	
70.	Agree. One could add that the ORSA in this case should focus on whether the risks taken by the pension fund are in line with the members' reasonable expectations.	
71.	ORSA is an useful tool on top of the holistic balance sheet. The holistic b/s is calculated by identifying many option elements. The ORSA can shet further light on the model and calculation assumptions made for determining all these option elements.	
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90.	Next to financial health and professional risk assessment, disclosure is also of key importance for the financial soundness of pension funds and the resilience of the pension system as a whole. Go for option 2. Complete convergence is desirable.	
91.	Yes, both for DB and DC schemes. Just as risk management, disclosure to stakeholders is becoming an increasingly important topic. Especially regarding pensions, public awareness used to be low and confidence regarding the benefits high. Due to successive economic crises, however, both funded and unfunded schemes are arguably affected in their ability to always meet the promised benefits. This has increased public awareness and correspondingly the need to improve communication. We therefore state the central question on disclosure as: * *Are the nature and risks regarding the benefits clearly and timely disclosed to all stakeholders?* Disclosure creates trust and facilitates well-informed decisions by all stakeholders. A high level of disclosure is needed where there is more scope for individuals to change the pension fund provider or where beneficiaries are substantially exposed to risks. In case the beneficiaries participate in a defined benefit plan, disclosure of information about the pension fund's assets and liabilities are	

	necessary to assess the exposure to shortfall risk. In case of defined contribution, disclosure should encompass items like expected benefits, default investment options, appropriate diversification and fees. High standards of disclosure will encourage trustees and managers to build transparent, comprehensible and responsible pension organisation and processes. The following questions are at the heart of this topic: • Is the pension fund clear about the nature of the benefits and the risks attached to them? * Is the communication tailored to the specific stakeholder groups and suited to their level of understanding?	
92.		
93.	Reporting both on short-term and long-term horizons is very important. A useful tool for this is a so-called “continuity analysis”. A continuity analysis is an important building block in regulating pension funds with long term commitments and long term investment strategies. It allows pension funds to gain grip on their dynamics in a situation fraught with uncertainty (DNB, 2007). The continuity analysis thus contributes to the assessment of a sustainable financial prospect for the pension fund and as a result, to the protection of beneficiaries' interests in both DB and DC schemes. The continuity analysis is strongly related to the common practice in the pension fund industry of Asset-Liability Management studies and has become increasingly important (see also, De Jong and Pelsser, 2010).	
94.	Yes, very good idea. This has already been introduced in NL (the so-called “UPO” = Uniform Pension Statement)	
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