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IVS
INSTITUT DER
VERSICHERUNGSMATHEMATISCHEN
SACHVERSTÄNDIGEN
FÜR ALTERSVERSORGUNG e.V.

Ergebnisbericht des Fachausschusses Altersversorgung

**Comments on EIOPA's Opinion to EU Institutions on a
Common Framework for Risk Assessment and
Transparency for IORPs**

*(Anmerkungen zu EIOPA's Empfehlung an die EU-Institutionen zur Verwendung
des Common Framework für die Risikobewertung und Transparenz von EbAV)*

Köln, den 05.10.2016

Präambel

Der Fachausschuss Altersversorgung der Deutschen Aktuarvereinigung e.V. (DAV) hat den vorliegenden Ergebnisbericht¹ erstellt.

Zusammenfassung

Der Fachausschuss Altersversorgung hat zur Empfehlung von EIOPA an die EU-Institutionen zur Verwendung des Common Framework für die Risikobewertung und Transparenz von Einrichtungen der betrieblichen Altersversorgung vom 14.04.2016 den vorliegenden Ergebnisbericht mit Anmerkungen zu dieser Veröffentlichung erstellt.

Der Ergebnisbericht setzt sich kritisch mit den Empfehlungen von EIOPA an die EU-Institutionen auseinander und bringt einen eigenen Vorschlag in die Diskussion ein.

Der sachliche Anwendungsbereich dieser Ausarbeitung betrifft Einrichtungen der betrieblichen Altersversorgung (EbAV).

Dieser Ergebnisbericht ist an die Mitglieder und Gremien von DAV und IVS zur Information über den Stand der Diskussion und die erzielten Erkenntnisse gerichtet. Er stellt keine berufsständisch legitimierte Position der DAV oder des IVS dar.

Verabschiedung

Der Ergebnisbericht ist durch den Fachausschuss Altersversorgung am 05.10.2016 verabschiedet worden.

¹ Der Fachausschuss Altersversorgung dankt der AG Internationales ausdrücklich für die geleistete Arbeit, namentlich Susanna Adelhardt, Lena Bauhuber, Nicola Döring, Alfred Gohdes (Vors.), Dr. Frank Halanke, Dietmar Keller, Andreas Kopf, Alexander Mänz, Volker Meusers, Oliver Roehrig, Elke Rossbänder, Katrin Schulze, Dr. Georg Thurnes, Dr. Thilo Volz, Marius Wenning, Frank Zagermann

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Comments on EIOPA's Opinion to EU Institutions on a Common Framework for Risk Assessment and Transparency for IORPs

of 5th October, 2016

by the German Institute of Pension Actuaries (IVS)

1.1 Preamble

EIOPA's Opinion to EU Institutions on a Common Framework for Risk Assessment and Transparency for IORPs, published on 14th April, 2016 (referred to as the "Opinion" below) is addressed to EU Institutions and drawn up at EIOPA's own initiative. It represents EIOPA's final assessment of how EIOPA itself and Europe's National Supervisory Authorities ("NSAs") should structure supervision of IORPs once the European Pension Fund Directive has been amended accordingly.

Although no commentary by stakeholders is invited, the IVS considers it important to comment on this Opinion, since it contains significant elements that deserve challenge. The IVS also suggests an alternative supervisory structure that would also be in keeping with IORP II and simultaneously be appropriate for IORPs.

1.2 Executive Summary

While the IVS agrees with and welcomes many proposals made in the Opinion, it disagrees with some of the fundamental principles of the Opinion since it considers them inappropriate for pension funds. The IVS recommends that urgent attention be given to rectify these issues and puts forward – at its own initiative – a proposal that it considers to be more in line with the spirit of IORP II.

In essence and in keeping with the European Commission's and its own long-held strategy, EIOPA recommends adopting the Common Framework ("CF", a new and better name for the much chagrined but unchanged previous approach), albeit only for purposes of risk assessment and transparency. It is indeed surprising and disappointing to the IVS that despite the many consultations conducted, EIOPA has not budged from its target adopted at the outset, namely to regulate pension funds in essentially the same way as it does insurers. It (re-)affirms its intent to ensure "a level playing field"² with insurers thereby consciously imposing an inappropriate regulatory straitjacket on IORPs.

² See section 141: it is not clearly stated there for what „players“ the „level playing field“ is to be ensured for. However, sections 66, 119 and 120 state quite clearly, that EIOPA (still) has the level playing field between insurers and IORPs in mind. This point of view was robustly and continuously challenged by many commentators on the grounds that IORPs typically have very different characteristics to insurers and have been operating under these regimes for decades, some for centuries. As opposed to insurers, IORPs are generally subject to very different operating and legal frameworks, have social and non-profit objectives, enjoy employer support, have different possibilities in connection with reducing benefits in times of hardship, etc.

We challenge that the potential for cross-sectoral regulatory arbitrage that EIOPA to eagerly wishes to counteract exists to any material extent. We have to date seen no evidence that fear of such arbitrage exists.

The Opinion often repeats that NSA's should be given "*sufficient powers to take supervisory action based on the outcomes of the CF ... to achieve supervisory objectives as defined by EU and national law*". Together with the repeated mentioning of the phrase "*at this point in time*"³ in connection with not introducing the CF for funding and capital adequacy requirements, this proposal seems to be in contradiction with the spirit of IORP II, under which the CF as proposed has been specifically ruled out as a measure for funding and capital adequacy.

1.3 Areas that the IVS supports

The IVS understands and appreciates the reasons for the establishment of a CF to assess the risk and funding situation of European pension funds. This goal makes eminent sense, as do those laid down in EIOPA's founding regulation, including:

- a) Fostering the protection of pension scheme members and beneficiaries;
- b) Improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision;
- c) Preventing regulatory arbitrage and promoting equal conditions of competition;
- d) Ensuring the taking of risks related to occupational pensions activities is appropriately regulated and supervised; and
- e) Contributing to the establishment of high quality common regulatory and supervisory standards and practices.

We have also noted and appreciate that the quality of the technical details of the Quantitative Assessment conducted by EIOPA in 2015 ("QIS II") has significantly improved from QIS I. We welcome the obvious effort that has been made to let pragmatism prevail in permitting simplifications to avoid the application of technically challenging and time consuming methodology. We also welcome the renaming of the previous approach into CF, since we consider it not to be a balance sheet.

We also consider that the expansion of the principle of proportionality to include a minimum amount of plan assets (€25m) is reasonable.

Finally, we welcome that EIOPA seems to be following a practical approach by allowing for a preparation phase that is being planned in case of implementation of the CF at the level of IORPs and we hope that this phase will be suitably long for IORPs to adequately prepare for.

1.4 Areas that the IVS challenges EIOPA's proposals in principle

The IVS believes that the Opinion does not meet the above objectives a), b), c) and e), since:

- a) The fostering of the protection of pension scheme members and beneficiaries will only be enabled at the expense of future generations. It is quite obvious that if the level of benefits for those existing members and beneficiaries that have already accrued benefits – in particular current pensioners – remains unchanged, the additional capital requirements implicitly but clearly being re-

³ This phrase is rather interestingly repeated 10 (!) times in the Opinion.

quired under EIOPA's proposals will lead to (significantly) less provision for future generations, especially if pension provision is voluntary as is the case in Germany. We believe that this is not in keeping with the European Union's basic policy objectives.

b) We do not believe that treating insurers and IORPs very similarly in all material respects is in agreement with either EIOPA's founding regulations or with the objective of a consistent level of regulation and supervision. Rather, we would expect that the regulation and supervision should be consistent between institutions having essentially very similar characteristics i.e. consistent frameworks for IORPs and insurers implies different frameworks for the two types of entities. Again, we believe this to be a fundamental principle which is not met by the Opinion's proposals.

c) and e) The reason why these principles are not met by the Opinion is given in b) above.

Interestingly, Article 1(6) of the EIOPA Regulation, EIOPA's objectives are, amongst others,⁴ a sound level of regulation and supervision as well as ensuring that the taking of risks related to insurance, reinsurance and occupational pensions activities is appropriately regulated and supervised. We believe that soundness and appropriateness of measures have been somewhat neglected in the Opinion.

In proposing how to implement the common risk-assessment for IORPs, EIOPA concludes that a market-consistent balance sheet and standardised risk assessment should be performed in accordance with a CF. This, in itself, is a perfectly valid objective to have. However, EIOPA then goes on to state that the most important measurement elements to be used should be the same risk free discount rate and risk factors calibrated to a 0.5% probability of occurrence over a one-year horizon. These fundamental building blocks are copied unchanged from Solvency II for apparently no other reason that it is "*most practical for EIOPA*"⁵ to recommend this. Fittingly, EIOPA nowhere mentions whether these fundamental elements are appropriate for IORPs.

EIOPA also recommends public disclosure of the CF results as and when they are produced. Clearly this is a political issue and not a technical actuarial one. However, we nevertheless wonder whether this should be required of all IORPs. Surely the only reason for consistency between different IORPs is in connection with cross-border activity on the grounds of a competitive level playing field between different IORPs. The public disclosure rules could thus be restricted to those entities in much the same way that Europe only requires capital-market oriented undertaking to present consolidated financial statements according to IFRS.

As already mentioned in the executive summary, the Opinion repeats strikingly often that NSA's should be given "*sufficient powers to take supervisory action based on the outcomes of the CF ... to achieve supervisory objectives as defined by EU and national law*". Together with the repeated mentioning of the phrase "*at this point in time*"⁶ in connection with not introducing the CF for funding and capital

⁴ See section 53 of the Opinion

⁵ Mentioned in the Executive Summary and in section 42

⁶ This phrase is rather interestingly repeated 10 (!) times in the Opinion

adequacy requirements, this proposal seems in contradiction with the spirit of IORP II, under which the CF has been specifically ruled out as a measure for funding and capital adequacy.

The Opinion also mentions EIOPA's report on results of QIS II conducted in 2015. In particular, it mentions the apparent risks and vulnerabilities that the results brought to light:

"The aggregate results show a 27% increase in the technical provisions (excluding benefit reductions) on the common framework's balance sheet compared to national balance sheets. IORPs in most Member States use a discount rate exceeding the current credit risk-free interest rate. Moreover, the common framework includes all types of benefits, which is not always the case in national frameworks.

"European IORPs face an aggregate shortfall of financial assets compared to liabilities (excluding benefit reductions), which needs to be covered by future payments of sponsoring employers amounting to EUR 1,037bn, ... "

While these statements are all technically correct, it is nowhere stated and argued why the credit risk-free interest rate would be an appropriate basis for measuring all the different pension fund structures existing in Europe. To answer this question is of central importance, since regulating industries with fundamentally different characteristics using the same regulatory framework can simply be inappropriate for one industry. If the chosen regulatory framework is inappropriate, then the results will obviously also be inappropriate.

We do not consider the credit risk-free interest rate an appropriate measure for all IORPs. Only very few IORPs liabilities are comparable in legal and commercial terms with those of insurers. Rather, we consider the expected rate of return on plan assets as appropriate because this captures the non-profit and risk-adjusted funding approach European pension funds typically follow.

We also believe that a 0.5% factor i.e. a 99.5% confidence interval is inappropriate for those IORPs that are operated for and behalf of members and beneficiaries of a single sponsor undertaking or group of undertakings. The reason being that sponsor support acts mitigatingly on the confidence level required by the IORP.

Regarding the Protection of members and beneficiaries, the Opinion claims that *"the information provided by the CF would allow for a better understanding of the risks and vulnerabilities of occupational pension schemes, contributing to their resilience and sustainability and improving the protection of members and beneficiaries."* We believe that this is not necessarily correct because the CF is not appropriate for the typical IORP for the reasons already mentioned above.

In its closing remarks in the Executive Summary of the Opinion EIOPA states that EIOPA expects *"that overall the benefits will outweigh the costs of the common framework"*. Additional cost will certainly arise for IORPs because the recommended CF is to supplement existing risk assessment tools do not replace them⁷. We question this statement because if the results of applying the CF yields inappropriate and therefore largely useless results, any cost will outweigh the benefits.

⁷ Section 24 of the Opinion

1.5 A proposal for an appropriate CF

Taking into account the principles to be established by IORP II, the IVS believes that the following proposal for a CF for a common risk assessment and transparency would be more appropriate for IORPs. The idea is really derived from what EIOPA itself formulates in sections 149 and 150 of the Opinion:

"The common framework is specified on a harmonised basis to facilitate consistency of approach and comparability between IORPs and between member states. As far as IORPs focus their risk management on the risk of not meeting the existing funding standards, the common framework may have even greater value for risk assessment purposes when it is supplemented with calculations based on discount rates which are aligned with prevailing funding standards.

For these IORPs, a standardised risk assessment calculated on technical provisions valued at a discount rate consistent with that used for the national funding standard may also be useful."

Considering that the IORP sector in Europe holds about half as much assets as the life insurance sector (€2.8tn vs. €5.5tn) and that the three main IORP-jurisdictions (by assets), namely the UK, NL and Germany, have very different legal and regulatory environments for IORPs that have been running along different tracks for centuries, and, additionally that two different risk management frameworks may well point to conflicting policies we propose:

1. The conceptual ideas underlying the CF are consistently applied in each Member State ("MS") in accordance with existing national risk management and funding standards applicable in each MS.
2. The main parameters for the CF (including discount rate, confidence levels and risk margin) should be subject to local and not harmonized Europe-wide specification. This would represent a framework that would make much more sense at a local level and hence be more useful at both the MS and IORP level. The IORPs themselves would be responsible for producing these results and would also make more sense to be published by IORPs.
3. The results thus produced under 2. above could then be easily rebased by estimation techniques at a European level by EIOPA itself. For example, if the duration of liabilities is provided at an IORP level in addition to the results under 2. above, EIOPA can easily estimate the technical reserve numbers itself and perform the risk assessments it considers suitable at a regional level. This way, EIOPA's objectives can be equally well met as under the proposals laid out in the Opinion.
4. Those IORPs engaged in cross-border activity in a competitive environment – and excluding those IORPs that are active only for a single sponsor undertaking or group of undertakings – could possibly be requested to perform the rebasing themselves.

From our point of view EIOPA's objectives can be equally well met under the proposal of the IVS as under the proposals laid out in the Opinion. In addition, the consistently applied framework under 2. above would be consistent with the requirements under IORP II without overstepping the risk management provisions therein. The framework would also be more appropriate for the overwhelming majority of IORPs in the European Union.