



Financial Services User Group's (FSUG)

13.01.2015

FSUG reply to the EIOPA Consultation Paper on Further Work on Solvency of IORPs

About FSUG

The Financial Services User Group (FSUG) is an expert group set up by the European Commission following the core objective “to secure high quality expert input to the Commission’s financial services initiatives from representatives of financial services users and from individual financial services experts”. The mandate of the group is to:

- advise the Commission in the context of the preparation of legislative acts or other policy initiatives affecting users of financial services, including consumers, retail investors and micro-enterprises;
- provide insight, opinion and advice concerning the practical implementation of such policies;
- proactively seek to identify key financial services issues which affect users of financial services;
- where appropriate, and in agreement with the Commission, liaise with and provide information to financial services user representatives and representative bodies at the European Union and national level, as well as to other consultative groups administered by the Commission, such as the European Consumer Consultative Group, the Payment Systems Market Expert Group, the European Securities Markets Expert Group and the Expert Group on Financial Education.

**Comments Template on
Consultation Paper on Further Work on Solvency of IORPs**

**Deadline
13 January 2015
23:59 CET**

Name of Company:	Financial Services User Group (FSUG)	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Confidential/Public
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Reference	Comment	
General Comment	<p>The Financial Services Users' Group (FSUG) welcomes the initiative of EIOPA on valuation and solvency of IORPs and supports the EIOPA initiative to make IORPs more transparent and stable in favor of members and beneficiaries. In the context of this work, FSUG thinks that the issues of IORPs' solvency should be treated very carefully within the context of IORP Directive review. Not only the HBS should be in the centre of focus, but also additional aspects related to PBS as the solvency of IORP should be clearly linked to the promises given to members (and sponsors) on one side and the transparency of expected benefits presented in Pension Benefit Statements. These two sides should be well balanced.</p>	

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Q1	<p>The word “contract” can be viewed as appropriate under the condition, that there is a real contract in place in reality. If the membership and thus the obligation of an IORP towards its members and sponsors is based on mutual agreement (social agreement), then the FSUG thinks that using the word “contract” should be well explained to cover all possible alternatives that are used in practice. IORPs usually do not enter into individual contracts with their members but are rather based on collective agreements. Usually the benefits offered (promised) to the members is defined in a pension plan, which is a subordinated document subject to additional multilateral (unilateral) changes and modifications during the accumulation phase of particular members, often without the express consent of these members. As the IORP could provide more than one pension plan and therefore “contracts” within one IORP could be different, the word “agreement” (or even “plan”) may look more appropriate.</p>	
Q2		
Q3		
Q4	<p>FSUG from the point of savers (even in cases where there is only an employer contribution and no employee contribution, obviously the employer contribution is part of the global remuneration of employees) has a slightly different view on this assumption. Members and future (and current) beneficiaries of IORP do not recognize the sponsor (employer) as the subject obliged to pay post-employment benefits (pension). Members (savers) are generally put into position that the respective IORP is responsible (and thus obliged) for the pensions.</p> <p>This shared responsibility with increasing level of obligations put on the IORPs should be recognized. When drafting the regulation on IORPs, the savers position should not be weakened by blurring the obligation to fulfill the "promise" set by either employer or IORP by its plan (product) as indirectly recognized in par. 4.27.</p> <p>IORP as an intermediary has the ultimate objective to provide the promised benefits for members (savers) and has been built by the sponsor to have the capacity (not only financial, but especially professional) to guide the sponsor in the process of achieving the adequate level of sources to fulfill the promises. Decreasing the responsibility of IORPs in this aspect and focusing only at the cash-flow recognized as technical provisions significantly diminish the level that should be achieved, meaning to have financially viable and stable IORPs able to deliver promised benefits.</p>	

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	The term "contract boundary" clearly recognizes the influence of Solvency II approach for (re)insurance undertakings. The meaning of this technical expression is clearly to recognize the limits of an agreement between the members (sponsors) and an IORP. However, it is often laid down in pension plan documents what kind of rights can be exercised by an IORP and under which circumstances such rights can be unilaterally or based on previous agreement exercised.	
Q5	If this is the reality in most MS, then this approach could be used. However, the FSUG thinks that only a limited number of IORPs have explicitly defined an "unilateral" right to change the agreement. In most cases, this is a bilateral (multilateral) right of more partners, but too often not of the members (savers) themselves This is related to the often weak governance of IORPs where the members (savers) too often cannot designate their representatives to the governing bodies, and/or their representatives are only a minority in those governing bodies.	
Q6		
Q7	The FSUG thinks there should be a clear distinction between these two things. Regular contributions are main part of an agreement; however the sponsor support is expected to be used only in special occasions, which should imply a different methodology of calculations and valuations. In the second case, credit risk arising from the position of a sponsor should be taken into account. If a sponsor support is called upon, usually the environment is not favorable for both IORP and a sponsor. Therefore, the valuation of sponsor support should take into account these risks.	
Q8	Yes.	
Q9	FSUG expresses its doubts on the practical occurrence of such payments from IORP to the sponsor. From the point of technical provisions, if such payments are probable to occur, they should not be included in the technical provisions.	
Q10	FSUG members are not aware of such examples, however there are many examples where only limited amount of contributions were paid. This is the risk that should be accompanied (and accounted for) by an IORP.	
Q11	FSUG members think that the definition of "contract boundary" should be tied (and treated) to the future benefits accrued to date if there is a right of a partner (sponsor) or an IORP to terminate or amend the future accrual of benefits.	

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Q12		
Q13		
Q14	Yes.	
Q15		
Q16		
Q17		
Q18		
Q19		
Q20	Yes.	
Q21	Yes.	
Q22	Yes, they are sufficiently defined.	
Q23	Yes, FSUG thinks, that examples cover most of the cases in reality.	
Q24		
Q25	FSUG thinks that there should be limited room for discretionary decision-making and benefits, as additional issues may arise. All possible aspects of decision-making as well as benefits awards should be precisely defined under the “agreement” or “pension plan”. This might limit the balance sheet “volatility” tied to the general macroeconomic situation, as the IORP will be forced to focus on balanced long-term decision-making and not on “saving and spending” short termism.	
Q26	Yes. There should be strict policy (pension fund) rules that limit and frame discretionary decision-making. This should be rule based decision-making.	
Q27	Pure discretionary benefits are not included in the pension fund nor IORP rules and therefore it would be unrealistic to value them for HBS.	
Q28	If there is an IORP policy or pension fund rules or reasonably probable intention of IORP and the sponsor to provide mixed benefits, there should be a requirement for best estimate of expected future payments based on various scenarios. However, the awarding of mixed benefit should be strictly allowed only if the IORP is in surplus and would not create additional pressure on sponsor, current members and/or future beneficiaries.	

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Q29	If there is no legal force on sponsor support, it would be unrealistic to make any kind of scenario valuations of future sponsor payments.	
Q30	Yes, we agree.	
Q31	Option 2 seems to fit the need better.	
Q32	Yes, we agree.	
Q33	Yes, we agree.	
Q34	Option 3 is preferred.	
Q35	We agree with these two options of benefit reduction mechanism valuation.	
Q36	<p>FSUG understands the importance of a sensitive approach towards the sponsor support valuation. At the same time, FSUG understands the EIOPA’s approach toward the principle based approach to valuing sponsor support with the specifics being left to member states/supervisors and/or IORPs. On the other hand, IORPs are the ones which are fully responsible for sound management of assets and liabilities. FSUG recognizes the existence of underfunded IORPs, where the sponsor support might be called up. However, alongside the principle based approach, there should be an “uniform” EU-wide consistent approach (second approach) that allows for clear market-consistent valuation of sponsor support as defined in 4.106: <i>“The value of sponsor support should be calculated as the probability weighted average of the discounted value of future cash-flows, that would be required to be paid by the sponsor to the IORP in excess of its regular contributions, in order to ensure assets in the IORP meet a required level.”</i></p> <p>This might increase the transparency and bring more transparency in the operations of IORPs across EU.</p>	
Q37	Fully agree.	
Q38	Agree on the allowing for affordability and credit risk of the sponsor as a general approach. For affordability, the sponsor should present its ability to finance the gap using financial analysis and modeling techniques. For the credit risk assessment, also the CDS could be used.	
Q39	FSUG thinks that as the promised benefits is a joint promise of a sponsor and managed (and delivered) by IORP, sponsor support as a balancing item should be the starting point of any valuation in the holistic framework. However, IORPs should be the first responsible for closing the gap on the HBS using “standard” measures and should not to overwhelmingly rely on the sponsor	

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	support.	
Q40	Principle 1 should be used for valuation of sponsor support in any cases. Principle 2 might lead (even with higher multiple “M”) to misleading valuation of a real sponsor support via derivative ways of presenting his strength. If the Principle 2 should be used, then the sponsor must present his support on his balance sheet (as a liability).	
Q41		
Q42	FSUG thinks (even when no calculations or models have been presented) to tie the multiple “M” to the size of the promised benefits the IORP (sponsor) has made to the member. This can be also explained by the principle: “The more you promise, the higher M should be present.” The promise made to the members should be treated on a relative basis, that is if an IORP promises higher replacement ratio, the expected benefits are becoming more significant in the overall expected pension benefits of the member. Rationally behaving members will therefore put more expectations and own contributions toward this IORP scheme. Such a rationale should be the starting point for determining an appropriate value of “M”. However, further analysis is suggested to achieve any consistent conclusion and decision.	
Q43	Yes under the strict condition that pension protection scheme (fund) covers 100% of liabilities and no forced changes (reductions, cuts, limitation, conditional provisions, extended contribution period, increased contributions of members and sponsors, etc...) in given promise and/or pension plan (agreement) will be applied onto IORP members.	
Q44	Yes, 100% benefit coverage principle should be used.	
Q45		
Q46	FSUG recognizes EIOPA as a sound regulatory and supervisory authority and thus leaves this decision to EIOPA as it claims in 4.145 that “EIOPA will consider carefully how to ensure that these methods and stochastic models produce comparable outcomes”. However, strong emphasis should be in place to ensure that methods developed by national supervisors will converge (not diverge) in time and will come closer to the probabilistic models rather than deterministic ones.	
Q47		
Q48		

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Q49	FSUG thinks, that also simplified deterministic model (“QIS1”) might be suitable for small and medium size IORPs, the principle mentioned in Q40 should be applied when recommending (allowing) the use of simplified models for sponsor support valuation. When the IORP uses sponsor support as a balancing item and the promise made by IORP toward its member is higher, the size of an IORP should not play a role and stochastic models should be used (and vice versa). Such an approach however might lead to the divergence among sponsor support valuation methods used by IORPs.	
Q50		
Q51	As this method seeks to be easy-to-use for many IORPs, it clearly has some limitations. Using this simplified method might lead to inconsistent (or even misleading) results especially due to the disadvantage mentioned under the “size effect”. Members of an IORP might thus be presented with better than reality figures.	
Q52		
Q53	This approach might be a suitable simplified method for determining sponsor support for many IORPs if the EIOPA develops the model further with clear guidance.	
Q54	Certainly yes.	
Q55		
Q56		
Q57	See the response in Q46	
Q58		
Q59		
Q60	For the time being, yes.	
Q61		
Q62		
Q63		
Q64		
Q65		

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Q66		
Q67		
Q68		
Q69		
Q70		
Q71	See response in Q43	
Q72	Option 2 (as described in 5.31 and 5.32), where the HBS could serve to help identify minimum funding requirements for IORPs which would be required to have sufficient assets to cover technical provisions seems feasible in the first phases.	
Q73	FSUG members think that using HBS in Pillar 2 should be the best starting point of implementation as it could lead to a higher transparency of governance for all parties involved and serve as a risk management tool. It should be noted that Pillars 2 and 3 may be interconnected and HBS could help in this way.	
Q74	Certainly yes. However, the EIOPA should work sensitively on easy-to-understand way of presenting the information to members.	
Q75		
Q76	FSUG prefers Option 2. The rationale behind our preference is that only the sponsor has the right to decide on support. The willingness of the sponsor should be irrelevant when considering assets available to cover the liabilities. Once the sponsor decides to provide support and his decision becomes enforceable; the sponsor support can appear on HBS of respective IORP. Otherwise, this item on HBS would be misleading for the participants (members, other sponsors, even regulatory authorities).	
Q77	Achieving a simple “yes/no” answer on this question is a rather complicated issue due to the fact, that even EIOPA recognized that “...if pension protection schemes were not included as an asset on the holistic balance sheet, the holistic balance sheet might show a (higher) gap indicating that there are not enough assets/resources available to pay the promised benefits, while in reality, due to the existence of a strong pension protection scheme, there would be enough resources available to pay the promised benefits. Even in the case of a weaker pension protection scheme, the holistic	

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	<i>balance sheet would show a larger gap/lack of resources than would actually be the case.”. On the other hand, the Pension Protection Scheme (PPS) is not the financing sponsor/member and thus should not be viewed as other source of financing. IORPs might be overwhelmingly reluctant to balance their balance sheets using “standard” tools and rely on the PPS and “better than expected future”. Therefore, the PPS can be viewed as a balancing tool and be included in HBS. The remaining question is the valuation of PPS, especially when it serves many sponsor and various IORPs. In “bad times” more sponsor and more IORPs might correlatively face higher gaps on their balance sheets. EIOPA and national regulators should therefore very closely look at the financial strength and conditions under which PPS will be called upon to help.</i>	
Q78	Agree.	
Q79	Option 3 is the preferred one. IORP should be required to classify the mixed benefits as either pure discretionary or conditional depending on the local market characteristics and the way how these benefits are treated among members, sponsors and IORPs on a local market. The national supervisory authorities might be required to define some rules to identify the nature of mixed benefits.	
Q80	FSUG thinks that the question should not be asked which option to adopt, but rather how to ensure, how the consequences of any option will be presented via pillar 3 measures to the members/beneficiaries to fully understand the rationale of this item. This is the key task of the regulation. If any option is adopted and such item appears on an IORP’s HBS, that it should have immediate interconnection with the PBS and should trigger actions not only internally, but also by national regulatory and supervisory authorities.	
Q81	See response in Q80.	
Q82	Agree.	
Q83	Agree.	
Q84	Agree.	
Q85	The approach (Level A in Option 2 or Level B in Option 2) should be used in direct interconnection with the type of promise the IORP and sponsor make to members. If the promise is “sure and guaranteed” than the Option 1 should be used. If a member is the risk taker (bearer) than the IORP is only intermediary on financial markets (most DC schemes with some minor guarantees)	

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	and there is a possibility to allow for softer approach (Option 2).	
Q86		
Q87	See option presented in Q85	
Q88		
Q89		
Q90	FSUG members think that there is certainly scope for harmonized principles on the recovery period for the sake of the protection of the members. Such maximum harmonization as defined in Option 1 will permit for a quicker (and potentially less severe cases) resolution and increase the possibility to establish cross-border IORPs as the regulatory arbitrage will be minimized.	
Q91	Shortest possible with early-warning mechanisms in place to quickly solve the situation and limit the spreading onto members, sponsors and potentially other IORPs.	
Q92	If a longer period is needed due to the objective reasons, the national supervisory regulator should be involved in a process.	
Q93	See response in Q90	
Q94	See response in Q91	
Q95	See response in Q92	
Q96	Agree. National supervisors should play a role in this process. EU-wide regulation should place general rules and processes.	
Q97	In most cases, there might be a significant impact on national SLL.	
Q98	Transitional measures should be the shortest possible, but this question is really dependent on the scope of a harmonized regulation.	
Q99		
Q100	It would be very unprofessional to comment on this question without having been able to see the results of wider analysis. The suggestion would be to have specified examples used in real-life testing and analysis (on a selected sample of typical IORPs based on various scenarios, pension promises made, size, residence, funding level, number of sponsors, etc.) to see the impact on questions defined in the paragraph 5.148 of the Consultation Paper.	
Q101		

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Q102	See response in Q100.	
Q103		
Q104	See response in Q100.	
Q105		
Q106	See response in Q100.	
Q107		
Q108	See response in Q100.	
Q109		
Q110	See response in Q100.	
Q111	HBS might become a suitable tool for pillar 1, 2 and 3. However, it would require a lot of work to make it a standard Solvency Capital Requirements, Risk Management and Transparency tool to help align the understanding of IORP financial position and promises made to members. FSUG thinks there might be some simplifications in the HBS, however they should be considered only under the conditions that it will not decrease the ability of sponsors, members and regulators to assess the real condition of the IORP regarding the pension benefits promises made and presented to the members.	