ACTUARIAL ASSOCIATION OF EUROPE
ASSOCIATION ACTUARIELLE EUROPÉENNE

1 PLACE DU SAMEDI
B-1000 BRUSSELS, BELGIUM
TEL: (+32) 2 201 60 21
E-MAIL: info@actuary.eu
WEB: www.actuary.eu

February 14, 2017

EIOPA
Att. Mr. Barthold Kuipers
Westhafenplatz 1
Frankfurt am Main
Germany

- By email only -

Dear Barthold,

The AAE welcomes the opportunity to engage with EIOPA in advance of the finalisation of the specifications for the 2017 IORP Stress Test. In particular, the meeting on 6 February between the EIOPA Stress Test project team and the three stakeholder organisations helped us to reach a better understanding of EIOPA's objectives and enabled us to set out our views on a range of issues related to the scope and implementation of the stress test exercise.

We note that EIOPA is very conscious of the need to minimise the burden imposed on IORPs by the stress tests requirements, and we agree that this is an important objective to ensure that a representative selection of IORPs in each member state participate in the exercise. In this connection, we queried why EIOPA were proposing to ask IORPs to undertake both a valuation (based on the Common Framework) and a cash flow analysis based on national specificities, as in our view the latter would be more insightful. We understand that EIOPA is of the view that a valuation on the Common Framework is necessary in order to compare the results with the 2015 Stress Test, and also to be able to develop a Europe-wide measure of the impact on employers and members, but that consideration will be given to adopting a cash flow methodology only from 2019 onwards. We are aware that for some IORPs, cash flows may not be readily available, or would not normally be reported to the supervisor, and it may be necessary to use approximations to derive the cash flows for the purpose of the stress test. We would note that given the current Brexit process, it may be difficult to convince IORPs based in the UK to participate and this may cause practical difficulties particularly with the cash flow analysis.

In this context, it is important that both the valuation and cash flow analysis are kept as simple as possible, and we welcome the EIOPA's intention to require a single stress to be tested, rather than three as in 2015.

An issue which we raised at our meeting, which is not directly related to the specification of the 2017 Stress Test, is that IORPs will need to develop, or where they already undertake risk assessments, review their processes to enable them to undertake the Own Risk Assessment introduced in Article 28 of the IORP II Directive. The objective of the European stress test is to enable EIOPA to aggregate impacts of stresses at a European level, whereas the risk assessment at Member State level and especially of each IORP would and should not copy this stress test without any amendments to take into account the requirements of national regulation and the specificities of each IORP.

In our view, the cash flow analysis should on this occasion be undertaken using a deterministic projection, although we recognise that stochastic analysis (particularly on the asset side) can provide richer information. The assumptions underlying the asset returns should be "real world" rather than risk neutral, with expected returns on different asset classes specified by EIOPA (as for the level B technical provisions under the QA and/or the DC Stress Test). We also believe that it would be sufficient to consider accrued unconditional benefits only, and in the unstressed scenario, to consider future contributions from sponsors only where these arise under a previously agreed recovery plan. This would enable the impact of the stress to be quantified as the additional cashflows required from the employer (based on national requirements) where sponsor support is legally enforceable, or the extent of the benefit reductions required where this is permitted under national law. In cases where sponsor support was not legally enforceable but was likely to be available, or where sponsor support is difficult to quantify e.g. multi-employer IORPs, some adjustment would be necessary.

The common framework for valuations should be based on a risk neutral approach if all risks are already included in the liabilities. In most cases this is not the case. In such situations the valuation has to be adjusted by adding an appropriate risk premium to the risk free interest rate. For more detailed background on this we refer to our paper 'Clarity before Solvency'[1]. Using risk free discount rates in all situations result in too high outcomes for the valuations and consequently a too pessimistic picture of the funded status of IORPs in Europe.

Modelling of security mechanisms and benefit reduction mechanisms is difficult as they are governed by very different rules in the Social and Labour laws of the Member States. Another important aspect of these mechanisms is that they require judgement in many cases and are not simply the result of a formula. We think the following framework could be generally applied in all Member States and is simple in its essence:

1. Assessment without additional sponsor support or benefit reductions
2. Identify how much money is needed to prevent a balance sheet gap (valuation approach) or a technical default (net cash flows become negative in a cash flow approach)
3. Feed information back to sponsor and representatives of members/beneficiaries who then should discuss what this would mean for sponsor support and/or benefit reductions. They will undoubtedly include national requirements (from SLL) into their considerations.
4. The local supervisor to challenge the decisions made by sponsor and member/beneficiaries' representatives
5. EIOPA to look at the aggregate results.

[1] *The AAE discussion paper 'Clarity before Solvency' was published in May 2015 and can be found here: http://actuary.eu/documents/AAE-Clarity-before-Solvency-19-05-2015-FINAL.pdf*

We believe that providing cash flow information is easier for those IORPs who perform ALM studies, continuity tests or sufficiency tests. This will, generally speaking, be the larger IORPs. You might want to decide therefore to focus on those larger IORPs for the cash flow approach as a first step.

'Stress' is now defined as a short-term severe shock. Another way of defining stress could be 'low for long', which would provide useful insights on possible developments with a longer term horizon.

We would be pleased to attend a further meeting with EIOPA before the specifications are finalised, if this would be of assistance, and to assist with "user testing" of the spreadsheets in April as we did in 2015. We appreciate that the timetable should be set so that results are published before year end, but we would urge EIOPA to give IORPs (and NCAs) sufficient time to understand the requirements and to undertake the required work (both quantitative and qualitative) to ensure that meaningful information is collected from which credible conclusions can be drawn.

Falco Valkenburg
Chairperson AAE Pensions Committee