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1 PLACE DU SAMEDI
B-1000 BRUSSELS, BELGIUM
☎ (+32) 2 201 60 21
✉ INFO@ACTUARY.EU
WWW.ACTUARY.EU

VIEW ON A CASH FLOW APPROACH TO ASSESS THE FINANCIAL RISKS OF IORPS

Whereas

- 1) There is large support to develop a cash flow analysis for the assessments of risks of IORPs¹
- 2) Stakeholders in the European pension industry are generally unhappy with the Common European Framework for the Assessment of Risks of IORPs as developed and used by EIOPA
- 3) There is no agreement on what discount rate to use (the AAE has presented its views earlier²)

We summarise our current view on the development of a cash flow approach:

1. AAE supports further exploration of cash flow analysis.
2. AAE believes that the results of a cash flow analysis is (by definition) richer of information than the results of a valuation.
3. AAE aims to respect social character of pension arrangement
4. AAE aims to respect national social and labour law requirements
5. AAE aims to produce realistic measures that may use a period to recover, rather than showing a big discounted number
6. AAE would position such a cash flow analysis first as supporting the quantitative aspects of the Own Risk Assessment under IORP II and second as a tool that could be used for Stress Tests on a national as well as on a European level.
7. AAE sees at least three key indicators summarising a cash flow analysis:
 - a. The length of the period that all due pensions can be paid (or how long does it take before all the assets are used for pension payments) (Time to default)
 - b. The size of the remaining due pension payments after all assets are used (Default deficit)
 - c. The number of times that not all due pension payments can be paid (Probability of default)
8. AAE makes a concrete suggestion for a step-wise approach:
 - a. Assessment without additional sponsor support or benefit reductions
 - b. Identify how much money is needed to prevent a technical default (net cash flows become negative in a cash flow approach)
 - c. Feed information back to sponsor and representatives of members/beneficiaries (social partners)
 - d. For social partners to decide what to do (e.g. additional money, benefit reductions)
 - e. Check solution complies with national social and labour law
 - f. National supervisor to challenge the decisions made by social partners
 - g. EIOPA to look at the aggregate results.

¹ EIOPA stakeholder group: [OPSG Position Paper on Risk Assessment and Transparency for IORPs](#), Frankfurt, 16-1- 2017

² AAE Discussion Paper 'Clarity before Solvency', May 2015 (https://actuary.eu/discussion_papers/clarity-before-solvency/)

9. AAE suggests having a committee of independent (from the pensions industry including supervisors, EU and national governments) experts to set the assumptions for the economic and demographic parameters. There are assumptions needed for at least a base scenario and an adverse scenario. Such parameters could be given as maxima or minima and don't have necessarily to be one number or one curve. In addition to the suggested scenario sets, assumptions to incorporate ESG risks must be given.
10. Finally, we note that a cash flow approach would also fit very well to generate relevant information on the risks that members of DC arrangements face.