Informal consultation: Comments draft 2019 IORP Stress Test Specifications	AAE 21 February 2020

Key

The "No" column refers to the ordering of comments received by EIOPA, not the section number (see below re "Reference" column)

In the "stakeholder" column, stakeholders should indicate their affiliation, e.g. OPSG.

In the "Reference" column, the section number should be inserted.

In the "Comment" column, stakeholders should insert their comments, including any suggested revised drafting (where appropriate)

The "Processing" column i.e. the response to the Comment will be filled out by EIOPA.

No	Stakeholder	Reference (Section)	Comment	Processing
1.	AAE	General remark	The AAE supports conducting stress tests. They are valuable tools to assess the possible impact an economic or demographic stress could have on the society at large including impact on individual households. IORPs have to conduct under IORP II an Own Risk Assessment (ORA) on a regular basis. The AAE would encourage alignment between the quantitative part of an ORA, the bi-annual European stress tests and other stress tests conducted by NSAs.	

			The AAE is pleased to see a further development of a cash flow analysis. The AAE sees advantages of a cash flow analysis in addition to a valuation approach as it: 1. Fits very well to an ORA 2. Enables an assessment of intergenerational fairness 3. Communicates well to stakeholders 4. Provides a uniform approach to both DB and DC plans 5. Can use real world economic assumptions when appropriate 6. Avoids discussions on which discount rate to use The AAE is also pleased to see a start with the assessment of ESG risks. Please note that our comments refer to the Stress Test 2019 specifications and the two new qualitative questionnaires. We have not reviewed the other questionnaires or the spreadsheets.	
2.	AAE	1.5	It says shortfalls have to be covered by future sponsor support and/or benefit reduction, but shortfalls can also be covered by excess return (during recovery period) or additional (employee) contributions.	
3.	AAE	1.11	We support analysing the impact of "risks stemming from shocks on the European IORPs sector may spill-over into the real economy with negative implications on economic growth and employment, triggered by increased sponsor support or benefit reductions". We	

			would add to that, that it is also very important to develop tools to communicate about such possible negative implications to members and beneficiairies and not only assess the collective impact on the real economy as a whole, and that current common balance sheet (CBS) or cashflow analysis alone are not suitable for communication to members. Nevertheless, we believe that the results of the cashflow analysis, if presented in a consumer friendly manner, are easier to understand.	
4.	AAE	1.13	We support the three main objectives. Vulnerability of plan members to adverse scenarios should ideally be seen in conjunction with first pillar pension entitlements, even though we are aware this is not a simple task, and that IORPs may not have sufficient information on members' first pillar entitlements.	
5.	AAE	1.22	The AAE is very pleased to see a start with the assessment of ESG risks. The breakdown as described could indeed be a first step. The indication of how much "brown" exposure is in our view not just 'rough', but rather 'very, very rough'. We would suggest to emphasize this somewhat more. As an example: an oil company would be classified as "brown". This oil company could, however already have "green" parts in its business and a lot of capital to finance a further transition to a greener economy, but is currently in the process of transitioning to a "green" status. Is this company still to be classified as "brown"?	

6.	AAE	1.31	Even though the assumptions used for the CBS (i.e. risk free, market consistent) could be relevant for the liability part of the cashflows, it could be argued that the impact of these assumptions is close to zero (if we ignore conditional indexation, or inflation linked to market assumptions for example) on the benefits side. However, they will definitely have an impact on the asset side of the cashflow projections. In our view, the base scenario should be based on real world assumptions (e.g. 300 bps expected risk premium for equities) and the scenario using risk-free investment returns would be a stress scenario. We would advocate for an adverse scenario that considers expected returns in excess of risk-free fail to materialise, or indeed that these excess returns turn out to be negative.	
7.	AAE	1.37	Vulnerability of plan members to adverse scenarios should ideally be seen in conjunction with first pillar pension entitlements, even though we are aware this is not a simple task, and that IORPs may not have sufficient information on members' first pillar entitlements.	
8.	AAE	1.40	it is a good development that the tool is extended to allow for deeper insights in the calculations and intermediate steps	
9.	AAE	2.4 + 2.5	The AAE would encourage a wide participation as the results of elements of the stress test on the level of an individual IORP could very well be or become a basis for the quantitative part of the ORA that IORPs need to conduct under IORP II.	

10.	AAE	2.5	In addition to a measure as percentage of AUM, we would suggest a measure of number of IORPs, in order to have a more diversified sample with smaller IORPs. It should be the national supervisor who decides which IORPs to consider in order to get this diverfied sample, as the market can be quite different from one country to another. This would ensure a better representation of the IORPs as 60% of AUM could sometimes be reached by a very limited number og (big) IORPs. As an example: in The Netherlands 60% of AUM can be achieved by assessing only some 3% of the number of IORPs (7 IORPs), which gives a very poor representation of the diverse pension field (>250 IORPs).	
11.	AAE	2.16	It's not clear to us why it is necessary to disclose the names of the IORPs participating in the stress test.It may be possible to link the individual IORPs to the data, and that could put not only IORPs but also their sponsors under pressure..	
12.	AAE	3.6	5th line: "ecocomic" → "economic"	
13.	AAE	3.7	We would encourage IORPs to discuss their own findings as part of their ORA.	
14.	AAE	3.8	Positive to see that EIOPA is aiming to make the process for IORPs as smooth as possible.	
15.	AAE	4.2	Including conditional benefits in the valuation is not straightforward and could create a significant amount of work for the smallest IORPs. As the Technical Specification indicates, there is scope to incorporate proportionate approaches as long as the degree of the approximation is not too great. We would welcome examples of what are the approximations accepted.The Common Balance Sheet approach does	

			not allow for the valuation of conditional benefits. Only if the pension payments are promised as a guarantee or the conditionalities of the pension payments are modelled into the expected cash flows the risk-free rate would apply as a discount rate. If not, and the expected cashflows are to some extent conditional and not a certainty, the discount rate used for a proper valuation has to allow for that. In these cases the valuation should be done on the basis of the risk-free rate plus an appropriate risk premium that would mirror the conditional aspects of the pension promise. See our discussion paper 'Clarity before Solvency' for further background. If these conditional pension payments are discounted with the risk-free interest rate only, the valuation result would overstate the liabilities. This could lead to wrong conclusions and misleading communication to members and beneficiaries.	
16.	AAE	4.9	We refer to our comment to paragraph 4.2. A market-consistent valuation will only be obtained if all the conditionalities of a pension promise are included in the expected cash flows. If not, and this is generally the case, the valuation could easiest be estimated using the risk-free interest rate curve plus an appropriate risk premium to mirror the conditionalities that are not modelled. The result should be the same (or very close) if the conditionalities would have been properly modelled into the expected cash flows and then discounted with just the risk-free interest rate curve (in other words, this is an attempt to estimate the valuation result in a simplified way and not an attempt to misstate (understate) the valuation of the liabilities).	

			Additional (employee) contributions should be taken into account also. A risk margin should not be included, given that IORPs are not-for-profit institutions and do not have costs of capital.	
17.	AAE	4.16	We very much agree. Similarly this should be the approach for the liabilities. Since this is usually not done in case of conditional liabilities, we would suggest a simplification and value the unconditional liabilities using the risk-free rate curve plus appropriate risk premium to reflect the conditionalities. See also our comments to paragraphs 4.2 and 4.9	
18.	AAE	4.26	The requested breakdown of corporate bond investments is very detailed. This is a lot of work for very little gain in terms of overall insights. We recommend aggregating at a higher level. Nevertheless we understand the importance of split between financial/non-financial in the assessment of the macroeconomic impact. We would suggest not to request this detail if it will be provided somewhere else (i.e. ECB reporting).	
19.	AAE	4.28	The requested breakdown of property investments is very detailed. This is a lot of work for very little gain in terms of overall insights. We recommend aggregating at a higher level	
20.	AAE	4.37	We fully support the requirement to cover the full lifetime of the pension obligations. Valuations both based on a national framework or on the European common framework are based on the same cash flows, thus it only makes sense to do this for the cash flow analysis as well. If not, important information	

			would be left out in the cash flow analysis, while it is included in the valuation analysis.	
21.	AAE	5.3,5.4	The paragraph between these 2 paragraphs is incorrectly numbered 1.1	
22.	AAE	5.36	The requested breakdown of corporate bond and real estate investments is very detailed. This is a lot of work for very little gain in terms of overall insights. We recommend aggregating at a higher level. Nevertheless we understand the importance of split between financial/non-financial in the assessment of the macroeconomic impact. We would suggest not to request this detail if it will be provided somewhere else (i.e. ECB reporting).	
23.	AAE	5.57	This approach to the level of granularity of the asset data seems much more reasonable. Why not apply this throughout the entire stress test and cash flow analyses?	
24.	AAE	5.65	In some jurisdictions the replacement rate of 'just' the occupational pension is not very informative as the replacement rate should be looked at as the combination of first and second pillar pension result. (e.g. in The Netherlands the old age pension is on average 50% first pillar and 50% second pillar) This would result in the following formula: Replacement Rate = (State Pension + (Pension Wealth at Retirement / price of 1 unit of payout)) / Final Salary	
25.	AAE	Investment Behaviour Questionnaire, Question 1c	It is not entirely clear what is meant and how the question differs from question 1b. It could be interpreted in two ways: - The question is about an absolute return target instead of an outperformance on the benchmark or	

			- It is about an outperformance on the benchmark, but with an explicit target return, for example 2% above the benchmark. We believe the first is meant. In that case we suggest to clearify the question by adding **absolute** return.	
26.	AAE	Investment Behaviour Questionnaire, Question 2.1	The question on the legal constraints seems to be very broad. In all cases there are legal constraints, like prudent person principle (fitting to the risk profile), legal exclusions etc. This could potentially be a very long list. Is the objective to state all legal constraints or could the question be further specified?	
27.	AAE	Investment Behaviour Questionnaire, Question 4	Investment *split* seems to be a strange term. We suggest to change it into Asset allocation.	
28.	AAE	Investment Behaviour Questionnaire, Question 5	What is the purpose of this question? The duration of all bond portfolios has increased because of the decrease in interest rates, so we expect most parties to state that indeed it has increased. If the meaning of this question is to ask whether the duration has increased because of strategical decision making, we suggest to clarify.	
29.	AAE	Investment Behaviour Questionnaire, Question 6/7	It is asked to state the duration as a %. This is incorrect, it should be stated as a number.	
30.	AAE	ESG Questionnaire General remark	We recommend that the order of the questions be amended to ensure they flow in a sequential and logical manner; i.e. Q3 (do you consider ESG factors) should come before Q1 (what classification system do you use).	

31.	AAE	ESG Questionnaire 1	Need to clarify what "entity specific system" is.	
32.	AAE	ESG Questionnaire 2	We suggest that questions are asked concerning the appointment of the asset manager e.g. in your manager selection do you consider whether they are a UNPRI signatory, whether they have a responsible investment policy, how do you assess the managers policy? The question could be extended to include "If yes, for what % of assets?"	
33.	AAE	ESG Questionnaire 7	The question should be reworded as "How do you implement your ESG objectives?"	
34.	AAE	ESG Questionnaire 7	We suggest that the question is asked in relation to specific asset classes e.g. what approach do you adopt for equities, bonds etc	
35.	AAE	ESG Questionnaire 7	We suggest that a question is asked about whether the IORP has its own voting and engagement policy or outsources this to an asset manager	
36.	AAE	ESG Questionnaire 14	The question could be reworded as "Have the sponsor and/or the members and beneficiaries sought to integrate ESG factors into your investment policy….."	
37.	AAE	ESG Questionnaire 15,17	The table in Q15 uses NACE section codes – not all asset managers will have access to this classification system. Paragraph 3.8 of the specification (which is referenced in Q15) states that IORPs may allocate assets using GICS, and Annex 5 provides a detailed mapping. It would assist those completing the questionnaire (who may be different people to those doing the stress tests) if the information in 3.8 and	

			Annex 5 was included in the questionnaire so that it was self-contained and easier to follow.	