

## Comments to EIOPA's Discussion Paper on a Methodological Framework for Stress-Testing IORPs

**EIOPA-21-399**

**21<sup>st</sup> June 2021**

### Responding to this paper

EIOPA welcomes comments on the "Second Discussion Paper on Methodological principles of insurance stress testing".

Comments are most helpful if they:

- respond to the question stated, where applicable;
- contain a clear rationale; and
- describe any alternatives EIOPA should consider.

Please send your comments to EIOPA in the provided Template for Comments, by email to [CP-21-003@eiopa.europa.eu](mailto:CP-21-003@eiopa.europa.eu) by **22<sup>nd</sup> September 2021**. Contributions not provided in the template for comments, or sent to a different email address, or after the deadline will not be considered.

### Publication of responses

Contributions received will be published on EIOPA's public website unless you request otherwise in the respective field in the template for comments. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

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<sup>1</sup> Regulation (EC) No 1049/2001 of the European Parliament and of the Council of 30 May 2001 regarding public access to European Parliament, Council and Commission documents (OJ L 145, 31.5.2001, p. 43).

<sup>2</sup> Public Access to Documents (See link: [https://eiopa.europa.eu/Pages/SearchResults.aspx?k=filename:Public-Access - \(EIOPA-MB-11-051\).pdf](https://eiopa.europa.eu/Pages/SearchResults.aspx?k=filename:Public-Access - (EIOPA-MB-11-051).pdf)).

<sup>3</sup> Regulation (EU) 2018/1725 of the European Parliament and of the Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC (OJ L 295, 21.11.2018, p. 39).

<b>Reference</b>	
Name of the Stakeholder	Actuarial Association of Europe
Type of Stakeholder (please delete in the column to the right the categories which do not apply)	Association
Contact Person	Monique Schuilenburg
Email address	moniques@actuary.eu
Phone number	003222016021
Address	1 Place du Samedi, B-1000 Brussels, Belgium

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<p>EIOPA will make all comments available on its website, except where respondents specifically request that their comments remain confidential.</p> <p>Please indicate if your comments should be treated as confidential, by deleting the word "Public" in the column to the right and leaving only the word "Confidential".</p>	<b>Public</b>

<b>General comments</b>		
<b>reference</b>	<b>Comments</b>	<b>[EIOPA response]</b>
General	<p>The actuarial profession would be happy to support on applying most adapted methods and assumptions for measuring the vulnerability and sustainability of pension sector in general and IORPs in special. We support EIOPA in their effort to illustrate what kind of methods could be available but are hesitant to support the approach of a toolbox. Each problem to be analysed requires adapted methods and assumptions, that can be existing approaches but that often are fine tuned to fit the purpose.</p> <p>We as the actuaries offer to support EIOPA, e.g. in making an expert judgement of what is the best approach. In the case of the stress test it is the supervisors in concertation with the sector to make a choice so that results can be consolidated on market and European level.</p>	
General	<p>Creating a framework for the test of the vulnerability of the IORP, the sponsor and the beneficiaries of the pension schemes is probably feasible. The framework will probably not be the same for all jurisdictions and all types of scheme.</p> <p>Developing a framework for the test of the sustainability in function of the economic and environmental consequences is more challenging. It involves much more aspects than purely pensions and IORP. It should be based on a in depth analysis of the influence of the IORP and be extension the pension system on all economic and social flows. This implies macroeconomic modelling and analysis that is normally done by the Central Planning Bureaus with extensive capacity.</p> <p>It seems that such analysis is needed so that the position of IORPs at the one hand but also of Pensions second pillar at the other hand is clear and can be discussed objectively.</p>	
15 and 192 ff	Local supervisors should select most appropriate participants for each exercise, so in each exercise new IORPs will participate in the stress test. The selection of participating IORPs need to be done in a way that the sample represents the characteristics and structure of the national market.	
26 and section 2.2.1	We considered as very important observation that the concept of solvency needs to be considered on national levels. For different pension schemes biometric or investment risks can be shared between the IORPs, sponsors and members of PPSs in different ways. In some cased these risks could be shifted by the	

	<p>IORPs to other ultimate risks takers. Therefore, performed stress test has to consider the impact on adverse scenarios on different stakeholders and on the financial stability of the IORPs in context of the national regulations. Shifting the biometrical and investment risks to other has significant implications on investment behaviour and investment choices made by IOPRPs. Such investment behaviour needs be considered and analysed not only with relation to impact on the real economy but also in the context of the poverty risk for people after retiring.</p> <p>Additionally, in different Member states the IORPs provide different types of obligations to their members and respectively different guarantees. With that regard ST should be focussed on the most important and meaningful elements for the different stakeholders. Considering the recent demographic trends and evolution of the pension schemes we should note the hybrid characteristics of the schemes – some of DC plans could have DB elements (like guarantees) and some DB plans may have DC characteristics in the future. Hence it is challenging to define one universal set of indicators and scenario for stress testing, that can be applied to each and every IORP.</p>	
43-48  121, 122, 128	<p>As actuaries we fully support the holistic analysis that appropriately might evaluate the objectives of the project. We want to point out that actuarial work is based on choosing the right methodology and assumptions in function of the problem to be solved and the use of our professional judgement where needed. Based on the above mentioned we think that it is difficult to set up the actuarial analysis in the universal tool box.</p> <p>In general, a ready for use toolbox could be useful for the particular exercise but the cost-benefit analysis need to be in place. The balance between investments in "ready-for-use" instruments and the materiality of the expected results has to be reached.</p> <p>Developing a framework for the test of the sustainability in function of the economic and environmental consequences is more challenging. It involves much more aspects than purely pensions and IORP. It should be based on a in depth analysis of the influence of the IORP and be extension the pension system as a whole on all economic and social flows. This implies macro-economic modelling and analysis that is normally done by the Central Planning Bureaus with extensive capacity. It is true that actuaries have an opportunity to be more involved in such work. The activities of the AAE Social Security subcommittee are entering this domain, here we are connecting this work to occupational pensions.</p> <p>It seems that such analysis is needed so that the position of IORPs at the one hand but also of Pensions second pillar at the other hand is clear and can be discussed objectively.</p>	

49	<p>Creating a framework for the test of the vulnerability of the IORP, the sponsor and the beneficiaries of the pension schemes is probably feasible. Most likely the framework will not be the same for all jurisdictions and all types of scheme.</p>	
50	<p>We find the suggested three instruments (tools) as applicable for the analysis on the ST outcomes. For Pension industry the quantitative analysis based on BS and CFs' projections is sufficient. In addition the survey can be used as an instrument for qualitative assessment.</p>	
58 and 59	<p>It is proposed to determine time value of technical provision by using the risk-free interest rate (58) (59).</p> <p>This is only the theoretically right approach in case the liabilities are either fully guaranteed or, if not, all conditionalities are already included in the cash flow that is used for the valuation. In cases where the liabilities do have conditional characteristics we see that those conditionalities are often not taken into account in the cash flows used for the valuation. In those cases using a risk-free interest rate would lead to a too high valuation outcome. In those cases the valuation should be based on the risk-free interest rate plus an appropriate risk premium. This risk premium should reflect the uncertainties of the liabilities due to the conditional characteristics they contain. This requires sound actuarial judgement. This is the way forward when applying a deterministic valuation, which is very common. If the same valuation would be carried out on a stochastic basis (the conditionalities are then translated into the cash flows for the valuation and then a risk-free interest rate is applied for the discounting) the outcome should be approximately the same.</p> <p>In the case that the liabilities fully depend on the outcome of the investments (e.g. a collective defined contribution system) the discount rate for the deterministic valuation should be set at the risk-free interest rate plus the risk premium based on the asset allocation. In other words in such situation is the appropriate discount rate equal to the expected return on the assets.</p> <p>In many situations the liabilities are neither fully guaranteed nor fully dependent on the development of the assets. In those situation actuarial judgement is needed to set an appropriate discount rate.</p> <p>Regarding the RFR we suggest to apply IORP-specific adjustment to the RFR before applying the interest curve (e.g. illiquidity adjustments or adjustments with respect of lower risk of cancellation). Different approaches to estimate the time value of provisions are possible and established in national markets. To achieve comparability we suggest deeper analysis and discussion of this point.</p> <p>Possible calculation of appropriate risk margin is not explained in document or template. But this issue needs to be discussed as the methodological approach for Solvency II doesn't fill for IORPs.</p>	

68	<p>Including management actions is an important part to achieve reliable results. On the other side implementation of management actions after each year of projection is very challenging. With each year uncertainty about current market conditions, labour law or tax implications is increasing and could impact the "real" management action. So, the significance of results is decreasing with each year of projection. Interpretation of results should always respect the number of years projected.</p>	
70	<p>All three different types of projection tools differ completely in which way results can be interpreted and for which purpose the results can be used. Complexity to implement each tool is different too. Therefore, we highly recommend not to use results from one tool for other than the specific stress test goal.</p>	
73 and 113	<p>The IRR gives more insight in the "financial ambition" than in the financial situation of an IORP. The IRR is important indicator which shows the level of investment return that could guarantee that all future benefits can be paid on the base of the current funding of IORP. We agree that IRR assessment gives only a rough indication that the solvency position of the IORP may be affected in some point in the future if the IRR is greater than the expected return. We believe that the IRR could be a useful instrument in the discussion with sponsors and member representatives as the concept is rather intuitive.</p>	
75	<p>This request results in a high complexity of calculation. Each national balance sheet must be simulated as well as the cashflow and their mutual reaction, together with management reactions (see 68). This is a really challenging task and results in some simplification to be applied during projection. Therefore, interpretation of results should take all model assumptions into account.</p>	
77	<p>Regarding time horizon of cash flows we would like to mention that it is obvious that with increasing years of projection uncertainty increases and reliability of results decreases. Of course all cash flows that are used in a valuation need to be included in a cash flow analysis. We wouldn't want to loose information. In the forward projection of the membership we would suggest to limit this to 20 years. In situations where the membership development is rather stable over the years, it is already enough to project only 1 year and use those outcomes to model the development of the fund for the subsequent years. This could be a very practical application of proportionality. Of course sound actuarial judgement is needed when such approximations are made.</p> <p>We would like to add that some assumptions should be used consistent when projecting assets as well as provisions, e.g. inflation rate</p>	

168	There are many possible tools, but a few of them are redundant for specific aims of stress test. Perhaps a kind of matrix "for which goal of stress test which tool" gives more insights	
177	This table is helpful to classify different cashflow	
314	Stress test does only refer to operational risk as a part of ORA exercise to be implemented by each IORP. It could be helpful to refer to ORA exercise for more aspects and we recommend to include certain scenario's in ORA and consolidate the conclusions and recommendations of the ORA vice versa in stress test results.	
397	We completely understand the aim of EIOPA and ESRB to implement climate stress. But the implementation of climate stress is currently really challenging, even with indication as given in 409 ff. Many of the indicators like NACE are currently not available for all asset classes.	
445		