

## AAE Draft Response to the EIOPA Consultation on the Supervision of Liquidity Risk for IORPs

Q1: The draft Opinion aims to be consistent with the FSB's proposed policy recommendations to enhance the liquidity preparedness of non-bank market participants. However, the draft Opinion covers all sources of liquidity risks within its scope rather than only liquidity risk relating to margin and collateral calls. Do you agree that the draft Opinion takes a comprehensive approach to liquidity risk of IORPs? Please explain.

The AAE broadly supports EIOPA's draft Opinion on enhancing liquidity risk preparedness for IORPs and acknowledges its alignment with the FSB's recommendations. Our members agree that a broad approach covering all sources of liquidity risk could enable comprehensive risk oversight and better accommodate the diverse financial and operational structures within IORPs across EU member states.

1. *Comprehensive Scope of Liquidity Risk:* The AAE broadly supports a comprehensive approach to liquidity risk, recognising that focusing only on margin and collateral requirements would overlook key risks that could impact liquidity. For instance, liquidity concerns may also stem from unexpected outflows, such as early withdrawals, or unforeseen cash flow issues on the asset side, such as missed investment income. This reinforces the need to cover diverse liquidity sources within the supervisory framework. The use of derivative instruments by IORPs may vary significantly between different countries, and therefore the level of importance attributed to derivative-related liquidity risk may also vary.
2. *Consideration of Additional Liquidity Risk Sources:* Our members favour a broad scope of liquidity risk to encompass margin and collateral-driven liquidity events, as well as benefit payments, investments in illiquid assets, and other sources of liquidity risk or liquidity events. Considering alignment with Solvency II to extend the scope to include risks from exposure to financial markets, repos, securities lending, and funding sources could be helpful. Furthermore, such an approach could streamline regulatory expectations, making it easier for IORPs and supervisors to assess liquidity needs and manage exposures proportionately.
3. *Proportionality and Focus on Material Risks:* While supporting the comprehensive approach, our members strongly believe EIOPA's framework should account for the proportionality principle, allowing IORPs to tailor their liquidity risk assessments based on exposure significance. For example:
  - If no reasonably identifiable sources of liquidity risk apply or no material liquidity risks are identified, then a simplified approach should be allowed. An example of proving non-materiality for derivatives, is that these are disallowed by investment guidelines.
  - If certain sources of liquidity risk are not significant for a Scheme, IORPs should focus on the material sources of liquidity risk.

A risk-based approach could enable IORPs with minimal or immaterial liquidity risks to adopt simplified frameworks, allowing them to direct governance efforts toward the most impactful liquidity risks relevant to their unique structures and avoid unnecessary administrative burdens. On the other hand, some of our members have suggested that a

“comply or explain” approach could be adopted where IORPs need to substantiate why they believe they are not subject to material liquidity risk.

4. *Risk Management Alignment with Broader Institutional Risks:* Liquidity risk could be managed with the same rigour as other major risks such as funding and operational risks, reinforcing the integration of liquidity risk within IORPs' broader risk management frameworks. By adopting this integrated approach, IORPs could better assess the interdependencies among risk types, thus avoiding gaps or overlaps in governance that might otherwise lead to inadequate liquidity preparation in critical situations.
5. *Proportionality and Avoidance of Over-Regulation:* The AAE considers it essential that EIOPA's framework strikes an appropriate balance between promoting good practices and avoiding undue regulatory burdens on IORPs. Regulatory requirements should reflect the reality of liquidity risk exposures rather than introducing spurious or fictive risks, which might result in resource-intensive compliance without tangible risk mitigation benefits. The framework should embody the principles of temperance and suitability by ensuring that any specified metrics or requirements are proportional to the actual liquidity risks faced by IORPs. For example, the demonstration of non-materiality should remain cost-effective and commensurate with the scale and complexity of an IORP's activities. Where investment guidelines already limit or prohibit the use of derivatives or mandate cash buffers, this should suffice as evidence of reduced liquidity risk. This approach would help ensure that IORPs can focus their resources on meaningful liquidity risk management rather than on administrative compliance processes.

Q2: Do you agree with the definitions of 'liquidity risk' and 'material liquidity risks' in paragraphs 3.1 and 3.2? Please explain your answer and provide any suggestions to improve the definitions.  
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The AAE broadly supports the definitions of "liquidity risk" and "material liquidity risks" as outlined in paragraphs 3.1 and 3.2 of the draft Opinion. However, our members have suggested some refinements to enhance clarity and align with the operational realities of IORPs, which are set out below.

1. *Definition of Liquidity Risk*: The current definition generally aligns well with IORPs' understanding of liquidity risk, yet some of our members propose a slight amendment for added precision. We suggest that the definition can be expanded to include events that, while not preventing the IORP from settling its liabilities, may significantly impact its financial condition. For example, such events could lead to compromises in funding levels, hedge ratios, or other critical metrics. These compromises, although not directly tied to an immediate inability to meet obligations, may have serious long-term implications for the IORP's financial health. This addition could clarify that IORPs should not necessarily need to liquidate investments at unfavourable prices under stress conditions. This may help distinguish between normal cash management and events that require forced sales.
2. *Relevant Banking Definitions*: Some of our members reference/linkage to the Basel III definition of liquidity risk, supplementing it with specific clarifications for IORPs. The proposal includes defining liquidity risk as the capacity to meet obligations as they arise without incurring unacceptable losses, with additional clarity on asset realisation, funding options, and collateral management as key considerations for IORPs.
3. *Clarification of "Material Liquidity Risks"*: Our members suggest making the definition of material liquidity risk clearer and more directive. This would help to clearly demarcate IORPs with material liquidity exposures, which would be subject to additional requirements, from those with lower risk profiles. Such clarity would enable proportionate application of regulatory measures while maintaining effectiveness. The current wording—"jeopardise the stability and soundness of IORPs and the protection of members and beneficiaries"—could be interpreted more precisely. For example, is the protection of members and beneficiaries jeopardised, when the realisation of such risks would result in benefit reductions? Further clarification could help capture the specific criteria for assessing materiality in this context.
4. *Inclusion of Financial Stability Considerations*: Certain members advocated expanding the scope of "material liquidity risks" to encompass potential systemic implications. They suggested that material liquidity risks could also include those with potential consequences for broader financial markets or other financial institutions. This added layer would align liquidity risk management with the broader financial stability goals upheld by EIOPA and help IORPs remain attentive to systemic risks. Such an extension would also provide coverage for scenarios that may affect IORPs in connection with wider market dynamics.
5. *Wider range of liquidity events*: It is suggested that the definition of liquidity risk could be expanded to include events that would impact on the financial condition of the IORP as they may be able to settle their liabilities, but this could potentially require other compromises, for example through a deterioration in their funding level (or other metrics such as hedge ratios etc.)

6. *Sponsor Covenant in Liquidity Risk*: IORPs' liquidity risk assessment should consider the ability and willingness of the scheme's sponsor to provide support (often referred to as "sponsor covenant"). For IORPs whose obligations depend on sponsor contributions or support, the strength of this relationship significantly impacts liquidity risk. Recognising the sponsor covenant as part of liquidity risk assessment would better reflect the unique reliance of certain IORPs on external financial support from sponsors.

Q3: The draft Opinion specifies that NCAs should gather relevant derivative data to assess liquidity risk exposures of IORPs. Are you aware of any issues or obstacles for IORPs: - in collecting derivative data from asset managers to monitor and assess liquidity risks in relation to margin and collateral calls; - in reporting relevant derivative data to NCAs? If 'yes', please explain.

The AAE acknowledges EIOPA's proposal for NCAs to gather derivative data from IORPs to assess liquidity risk exposures, particularly regarding margin and collateral calls. While our members appreciate the potential benefits of this data collection for enhanced risk monitoring, they also noted several practical considerations and obstacles.

1. *Need for Consistent and Usable Reporting Templates:* Our members suggest that collaboration between EIOPA, NCAs, and IORPs on standardised reporting templates could improve the usability and consistency of derivative data reporting. Derivative reporting formats in other frameworks, such as Solvency II's QRT S.08, have been criticised for inconsistencies and interpretative ambiguities, which complicate data aggregation and analysis. Engaging with IORPs in designing usable reporting templates could mitigate these issues, making the reporting process both more manageable and more informative for supervisors.
2. *Consideration of Pooled Funds and Investment Strategy:* The use of pooled funds can complicate the gathering of data and reporting of liquidity risk. IORPs and their trustees are often dependent on reporting provided by investment managers of funds and products with significant derivatives exposures, in terms of the manager's capability and willingness. Aligning reporting requirements with existing regulatory frameworks applicable to fund managers would improve consistency. Additionally, consideration should be given to the different approaches to managing collateral calls across pooled funds, segregated mandates, and fund-of-one structures, as well as investment strategies (e.g., LDI funds using derivatives as a core strategy vs. multi-asset funds using derivatives for efficient portfolio management or currency hedging). The guidance could also consider a distinction between funds that can request additional capital from investors and those held for risk management purposes, where the exposure may be reduced if no additional investment is made when needed.
3. *Proportionality/Materiality and Data Reporting Requirements:* Where investment guidelines limit or prohibit the use of derivatives, reporting requirements should be proportionate to avoid unnecessary burdens on IORPs and increased costs stemming from third-party asset manager fees. However, if an investment vehicle is set up explicitly to implement an ALM or LDI strategy with extensive derivative usage, appropriate reporting should be expected as a foundation for effective supervision by NCAs. Consistent treatment of derivative-related risks is essential, regardless of whether assets are managed internally or externally.
4. *Necessity of NCA Capability for Effective Supervision:* Members expressed concerns regarding whether all NCAs have the expertise and resources necessary to assess complex derivative data effectively. Collecting data that is neither actionable nor feasible to process could limit its practical benefit. An assessment of local supervisors' capabilities to assess derivative risk using complex market data could ensure that data collection initiatives translate into meaningful supervisory oversight.
5. *Challenges in Collecting Derivative Data from Asset Managers:* Collecting derivative data from asset managers could be challenging due to the complexity of derivatives used in

fund mandates. For instance, pooled or multi-asset funds using derivatives for purposes such as currency hedging may have exposures that vary over time and are often fully delegated to the manager. Such exposures may not represent material liquidity risks to the IORP and could reasonably be excluded from reporting requirements. Since IORPs often delegate derivatives management to external asset managers, the risks linked to these instruments largely depend on the asset managers' strategies. The same instrument can carry different implications for each IORP based on their unique asset-liability profile.

Q4: The draft Opinion envisages a two-step approach. IORPs should first assess whether they are exposed to material liquidity risk and, if so, integrate liquidity risk in their system of governance and risk-management system, including an assessment in their own-risk assessment (ORA). Do you agree with this two-step approach? Please explain.

The AAE broadly supports EIOPA's proposed two-step approach for integrating liquidity risk assessment within the IORP governance and risk management systems, starting with an evaluation of material liquidity risks and, if applicable, including this in the ORA. However, our members highlighted some additional points and recommendations for enhancing clarity and proportionality.

1. *Consistency with Broader Risk Management Framework:* Liquidity risk should be embedded within the overall risk management cycle, alongside other significant risks, such as solvency/funding and operational risks. This includes identification, measurement, comparison to risk tolerance, and mitigation options. Governance and risk management systems are natural extensions of this process, with daily risk management and the ORA acting as key frameworks for capturing the relevant liquidity risk aspects. The materiality of liquidity risk would naturally be derived from this cycle, as the residual impact is assessed against established risk tolerance thresholds.
2. *Proportional Approach to Risk Assessment:* We support the two-step approach and suggest additional guidance on applying proportionality, especially for IORPs with low or negligible liquidity risk. Publishing a checklist or decision-tree could help IORPs interpret proportionality and apply it consistently. This would assist in determining when simplified assessments are appropriate versus when a more detailed assessment is required. We believe that a spectrum of approaches, tailored to the materiality of liquidity risk, would be more appropriate than a binary distinction, which may oversimplify risk management for complex IORP structures. For IORPs with material liquidity risks, this could include enhanced measures, such as implementing a collateral waterfall, to strengthen risk management frameworks.
3. *IORP-Specific Liquidity Needs in ORA:* Liquidity risk varies widely across IORPs due to factors like obligations, cashflow patterns, sponsors and derivative use. The ORA offers a suitable and tailored space for addressing liquidity risk based on each IORP's specific characteristics. In practice, the majority of IORPs already consider liquidity risk within their ORAs, aligned with the requirements of the IORP II directive. Where material liquidity risks are identified, further mitigation and risk management steps are typically undertaken. Formally, incorporating liquidity risk into the ORA could thus strengthen the overall governance framework by accommodating these nuances.

Q5: The draft Opinion provides in paragraph 3.6 suggestions for possible sources of liquidity risk that IORPs are exposed to. Are you aware of any other sources of liquidity risk that should in your view be explicitly addressed? Please explain your answer.

The AAE appreciates EIOPA's outline of possible sources of liquidity risk for IORPs in paragraph 3.6 and broadly agrees with the identified areas, including margin and collateral calls, early withdrawals, and pension transfers. Although, our members have suggested additional sources that could provide a more comprehensive framework for liquidity risk assessment:

1. *Broader Definition of Potential Liquidity Triggers:* Limiting liquidity risk assessment to specific events (such as margin calls, withdrawals, and transfers) could lead to an incomplete view of the risks faced by IORPs. A broader definition that encompasses all factors potentially impacting an IORP's ability to meet its obligations could be considered. Such an approach would align with the fundamental definition of liquidity risk as the inability to realise investments or assets to meet financial obligations. In addition, liquidity risk can differ significantly for each IORP based on its structure, funding design, and underlying obligations. IORPs structured with stronger sponsor support may experience lower liquidity pressures compared to those relying solely on investment inflows. Adopting a broad and adaptable definition of liquidity risk could enable IORPs to assess the full range of events or conditions impacting liquidity based on their specific operational context.
2. *Cash Inflow volatility:* Liquidity risks may arise not only from unexpected cash outflows but also from reduced or delayed cash inflows. If cash inflows from contributions or investments are unexpectedly low, even planned outflows could lead to liquidity shortfalls. Including cash-inflow volatility as a source of liquidity risk would address scenarios where liquidity issues arise independently of market risk.
3. *Illiquid Asset Classes and Capital Calls:* Liquidity risks also arise from IORP investments in illiquid asset classes, such as property, infrastructure, private equity, and private debt. In particular, capital calls and drawdowns associated with these investments pose unique liquidity challenges, especially as these assets may be unredeemable in crisis periods or restricted by redemption gates. There may also be explicit fixed-term periods for these investments. As these asset classes are increasingly adopted in DC portfolios, they should also be particularly considered in the context of ongoing cashflow needs for these members, including the risk they wish to transfer their assets externally.
4. *Consideration of Additional Derivatives, Repos, and Securities Lending:* The consultation emphasises liquidity risks related to interest rate swaps; however, other derivative types, particularly leveraged or synthetic equities, longevity swaps, inflation swaps and credit instruments, may also introduce liquidity pressures. In some markets, there may also be funds or investment approaches that combine leveraged LDI and equity exposure, further increasing liquidity exposure and risk. Additionally, repo markets and securities lending arrangements can impact liquidity by requiring ongoing collateral, especially in stressed market conditions. Including these liquidity risk sources could improve preparedness for diverse market environments and stress scenarios.
5. *Annuity Assets:* Annuities are increasingly forming part of the investment toolkit, and could pose a liquidity risk. If the purchase of an annuity is funded from a substantial portion of liquid assets within a scheme, but there remain cashflow requirements from the scheme that are not covered by the annuity, then liquidity risk is present. These



trade-offs would be expected to be assessed and understood as part of any investment decision-making process regarding annuities.

6. *Longevity Swaps*: Although not common in the EU market currently, longevity swaps may pose a liquidity risk if their adoption increases. These instruments often involve initial collateralisation, and ongoing margin calls similar to variation margin under other swaps. While these risks would likely materialise over longer time horizons, they remain an area for future consideration.

Q6: Do you agree that IORPs with material liquidity risk exposures should establish a contingency plan to deal with liquidity stress, as expected in paragraphs 3.8-3.10? If 'no', please explain why and provide any suggestions on what other measures IORPs would put in place.

The AAE generally supports the expectation that IORPs with material liquidity risk exposures should establish a contingency plan to address potential liquidity stress, as outlined in paragraphs 3.8–3.10 of the draft Opinion.

Our members emphasised the value of contingency planning as a governance practice, while also highlighting considerations for proportionality and flexibility in its implementation.

1. *Contingency Planning as Good Practice*: Contingency planning is widely regarded as good practice for managing significant risks, including liquidity risk. Developing a plan in advance to address material liquidity stress could support timely decision-making, role assignments, and evaluation of alternative funding options under adverse conditions. Good governance practices, including decision-making structures and predefined roles, can enable IORPs to respond promptly to liquidity needs and mitigate potential adverse effects.
2. *Proportional and Tailored Contingency Plans*: We note the importance of proportionality in contingency planning, considering that IORPs with lower liquidity risk exposure should have flexibility in the scope and detail of their plans. A proportional approach would allow IORPs to tailor their contingency measures to the materiality of their liquidity risk, ensuring that plans remain relevant and effective without imposing unnecessary administrative burdens. This approach would align with the varying levels of liquidity risk across IORPs, making contingency planning both practical and fit-for-purpose.
3. *Enhanced Contingency Measures*: A proportional and appropriate contingency plan could include the development of a collateral or liquidity waterfall to address liquidity needs under both standard and stressed scenarios. Such a plan would establish clear measures from both a portfolio and investment perspective, as well as an operational and governance perspective.

For IORPs considering repo agreements to meet liquidity needs in stress scenarios, it is expected that this option would only be viable for the largest and most sophisticated IORPs and not be widely applicable. Similarly, contingency planning could address the potential need to close out investment positions, either directly or through outsourced investment providers, ensuring the IORP has processes in place for managing such situations.

It is worth noting that the market, including both IORPs and outsourced investment providers, has already made significant progress in considering and implementing these types of contingency plans.

4. *Interconnected Risk Management*: Finally, it should be acknowledged that the materialisation of liquidity risk can, if managed correctly, contribute positively to the financial condition of IORPs. For instance, during the UK gilts crisis, while some defined benefit schemes faced challenges, many experienced improved financial positions due to rising interest rates. This underscores the importance of managing all risks in a proportionate and interconnected manner, rather than focusing exclusively on one risk to the detriment of others.

Q7: The draft Opinion provides in paragraph 3.12 that IORPs should define their own liquidity risk indicators for day-to-day risk management. Subsequently two examples of commonly used risk indicators (liquidity coverage ratio & excess liquidity indicator) are suggested. Are you aware of any other liquidity risk indicators that are commonly used by IORPs? If 'yes', please explain.

The AAE generally supports the use of liquidity metrics and indicators to assess IORPs' liquidity positions, with members recommending a range of methods and highlighting considerations unique to the IORP context. Below are key points raised by our members on the application of liquidity indicators:

1. *Adapting Basel III Metrics for IORPs:* Certain Basel III liquidity metrics, such as the Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR), and High-Quality Liquid Assets (HQLA) definitions, could be adapted for use by IORPs. Minimising deviations from EU banking definitions could help consistency and comparability, especially in relation to HQLA, which reflects financial market standards. Using a standardised approach to liquidity classifications would also align IORPs with other financial institutions.
2. *Indicators Reflecting Stress Absorption Capacity:* Liquidity indicators that show the capacity to absorb market stress—such as the headroom or liquidity buffer available relative to derivative exposure—may offer a more dynamic view of liquidity risk. The use and monitoring of collateral waterfalls and liquidity ladders, like those mentioned in the response to Q6, are valuable tools for ongoing risk management. In addition, indicators that focus on the level of stress an IORP can absorb, rather than a static ratio, may provide a more meaningful understanding of liquidity resilience. For example, stating 'the IORP can withstand a stress of a 3.5% rise in nominal yields' offers more insight than simply reporting 'the IORP has a liquidity coverage of 2 times.'

Within liability hedging portfolios for defined benefit schemes, headroom indicators are particularly effective. Such headroom can be expressed in terms of:

- A% 'within' a pooled LDI fund,
- B% 'alongside' a pooled LDI fund or hedging portfolio (e.g., in liquid cash funds held by the manager), and
- C% 'available to' the structure via non-cash but expected-to-be-liquid asset classes held by the manager.

Other commonly used indicators include:

- Yield rise to first capital call and size of subsequent call.
- Yield rise to exposure exhaustion.
- Percentage of assets realisable (through notice, trading, or settlement states) within X days.
- Cash or capital needed to return a derivative portfolio to safer leverage levels compared to available liquid assets. These indicators capture the dynamic nature of liquidity risk as markets fluctuate.

3. *Liquidity Ratios and Market-Specific Adaptations*: Liquidity ratios are commonly used metrics but may vary significantly depending on asset classes and the realisation period involved. For highly liquid assets, monitoring on a frequent basis may be feasible, while for less liquid assets, a longer-term view may be more practical. Regular monitoring of indicators for asset classes, including derivatives, could enable IORPs to track liquidity trends effectively. When derivatives are managed by external asset managers, regular information on their liquidity profile may support oversight and risk management.

Q8: Do you agree that IORPs with material liquidity risk exposures should establish and maintain a clearly defined liquidity risk tolerance statement approved by the management or supervisory body of the IORP, as expected in paragraph 3.14? If 'no', please explain why not and provide any suggestions on alternative practices used by IORPs.

The AAE has the following views regarding the need for IORPs with material liquidity risk exposures to produce a separate formal statement of liquidity risk tolerance.

1. *Existing Risk Tolerance and Integration into Investment Policies:* Some members believe that existing risk tolerance statements, along with the IORP's Strategic Asset Allocation (SAA) and Statement of Investment Policy and Principles (SIPP), already provide a sufficiently clear framework for addressing liquidity risk tolerance. The SIPP, which is required to include the risks underpinning the investment strategy, presents a practical and pragmatic approach to documenting the nature, mitigation, and management of liquidity risk. Since the SAA/SIPP often include cash or highly liquid assets as a buffer, this structure inherently reflects the IORP's liquidity risk tolerance and can be adjusted if risk tolerance levels change. Furthermore, the Own Risk Assessment (ORA) and risk management policies already consider material liquidity risks and stress scenarios, making a separate formal statement redundant and potentially duplicative.
2. *Integration into Existing Policies:* The existing requirement for IORPs to produce a Statement of Investment Policy and Principles (SIPP), which must include consideration of risks underpinning the investment strategy, presents a practical and pragmatic approach to addressing liquidity risk. Including further details on the nature, mitigation, and management of liquidity risk within the SIPP would be preferable to creating a separate standalone policy document. This approach aligns with the evolving practice of considering liquidity risk as part of the ORA process, where further mitigation and management steps are documented when material risks are identified.
3. *Integration into other relevant policies:* As previously mentioned liquidity risk can also stem from other risks than just investment related risks. This could be biometric risks (e.g. large payouts from mortality risk), lapse risk or insurance-risk-related derivatives or reinsurance vehicles. Relevant risk tolerance limits for liquidity risks related to these areas should therefore be incorporated in the relevant policies covering these risks.

Q9: The draft Opinion prescribes in paragraph 3.15-3.16 that IORPs should regularly review and update their liquidity risk-management system. What would in your view be appropriate triggers and minimum requirements for such a review?

The AAE would agree that a regular review of an IORP's liquidity risk management framework is essential and that certain trigger events could prompt an additional review to ensure its ongoing effectiveness.

1. *Regular and Triggered Reviews:* We generally support incorporating liquidity risk within the regular review process for the IORP's risk management system. Some of our members have suggested a structured review cycle, such as an annual review with a more in-depth assessment every 3–5 years, to align with standard practices. Additionally, a separate review may be warranted in response to specific events or changes, such as a shift in the IORP's business model, funding structure, or prevailing financial market conditions.
2. *Event-Driven Review Triggers:* Our members noted several specific events that could trigger an immediate review of liquidity risk management. These include:
  - A change in the investment strategy which materially alters the liquidity profile of the assets.
  - Events planned or occurring that may result in significant short-term benefit outflows, such as enhanced transfer or early retirement terms, or redundancy exercises.
  - Changes in the nature of the scheme, such as closure to new entrants or future accrual, which could lead to a significant reduction or cessation of incoming cash flows.
  - Regulatory changes, such as those introducing less predictable cash outflows (e.g., the pension freedom legislation seen in the UK in the 2010s).

Such triggers would warrant a thorough review of the liquidity risk management system to ensure its effectiveness under evolving circumstances.

3. *Breach of Liquidity Indicators or Emerging Risks:* A review may also be appropriate if there is a significant breach in chosen liquidity risk indicators or a deterioration in the IORP's ability to meet its obligations. New sources of liquidity risk or forms of liquidity pressure not addressed within the current framework could also justify a review. Insights from the Own Risk Assessment (ORA), particularly regarding specific stress scenarios, may also identify areas for improvement within the liquidity risk management approach.
4. *Role of the Risk Management Function:* Our members highlighted the role of the risk management function in overseeing liquidity risk, suggesting that this function could be responsible for initiating reviews when necessary. Since the risk management function continuously monitors the IORP's risk environment, it is well-positioned to assess when changes to the liquidity risk management framework are required. Including liquidity risk as part of the overall risk management review process would ensure that it receives regular oversight and timely updates as needed.

5. *Minimum Requirements for a Review:* We expect that as part of a review, IORPs could:

- Reassess the sources of liquidity risk to which they are exposed.
- Update contingency plans or collateral/liquidity waterfalls as necessary.
- Revise liquidity risk indicators to reflect updated risk profiles.
- Review operational risks related to managing or responding to liquidity risk.

Q10: Do you agree that IORPs should perform stress tests and scenario analysis covering all material sources of liquidity risk, and assess the impact of a range of severe, but plausible liquidity stresses, as expected in paragraphs 3.17-3.20? Please explain and provide any suggestions on the proposed minimum requirements for the stress tests and scenario analysis.

The AAE broadly agrees that IORPs with material liquidity risk exposure should conduct liquidity stress tests and scenario analyses. However, our members highlight that due to the diversity in IORP structures, investments, and obligations, a principles-based approach that allows for flexibility and takes into account the differences in regulatory and operational frameworks of different countries may be most effective.

1. *Principles-Based Approach to Stress Testing*: Given the unique cash flow profiles, asset allocations, and liability structures of different IORPs, we would support a principles-based framework that enables each IORP to design relevant and realistic stress scenarios. The basis of liquidity stress tests should include projections of expected cash inflows and outflows, particularly in light of potential adverse scenarios. For defined benefit (DB) schemes, the sensitivity of assumptions used in actuarial valuations may be informative, allowing for scenario selection that reflects a scheme's specific risk profile. Stress scenarios should err on the pessimistic side although should be plausible, incorporating earlier than expected, or increased, cash outflows and reduced inflows.
2. *Suitability of Standardised and Bespoke Scenarios*: While IORPs should primarily design bespoke scenarios tailored to their specific circumstances, there may also be value in defining standardised stress tests to allow for regulatory comparison and aggregation. Such standardised tests could provide a reference point, especially in understanding extreme scenarios, while allowing regulators to assess sector-wide liquidity resilience. Even if some scenarios seem less likely or plausible from an IORP's perspective, assessing the impact across a spectrum of possible scenarios may prompt re-evaluation of risk mitigating actions and enhance resilience.
3. *Appropriate Variables and Combined Scenarios*: Liquidity stress testing could examine the impact of variables such as interest rates, inflation rates, and foreign exchange (FX) rate changes at different confidence levels, alongside the effects of equity market shocks. One approach could involve testing changes in these variables individually and in combination, including assessing real yield changes (a combination of interest and inflation rate shocks) at different confidence levels. Aggregated shocks should remain plausible, and their convexity effects, particularly in derivative portfolios, should also be considered for significant movements in these rates. Scenario analysis could also include the effect of unexpected cash flows, such as a significant volume of transfers or retirements, expressed as a percentage of non-pensioner liabilities or a multiple of projected annual outflows. The analysis should consider not only the direct liquidity impact but also the broader funding implications, the ability to replenish liquid assets, and secondary knock-on effects on the IORP's overall position.
4. *Real-Time and Ad-Hoc Stress Testing Feasibility*: Our members also noted that while it is essential for IORPs to prepare for adverse liquidity events, continuous or intraday stress testing may be challenging and impractical, especially for IORPs with diverse and less liquid portfolios. Instead, stress tests should be structured to test the IORP's capacity to respond to adverse events when they arise. Preparedness in such cases may include pre-defined action plans or role assignments to manage liquidity shocks promptly when stress events materialise.



Q11: Do you agree that IORPs should maintain an adequate buffer of liquid assets to cover any shortfall of incoming relative to outgoing cash flows, also under severe but plausible stress conditions, as expected in paragraphs 3.21-3.23? Please explain and provide any suggestions on the conditions imposed on the liquid assets in paragraph 3.22 and 3.23.

The AAE generally supports the establishment of a minimum liquidity buffer for IORPs with material liquidity exposures. Members agree that maintaining a sufficient level of liquid assets can help address unexpected cash needs, while emphasising that buffer requirements should remain balanced to avoid unduly impacting investment returns.

1. *Principles for Buffer Composition and Haircuts:* The buffer should primarily comprise assets with low volatility, such as cash and high-quality government bonds, which tend to be more resilient in stressed market conditions. However, IORPs should have discretion to determine which assets are considered liquid, based on an appropriate set of principles rather than a prescriptive list, such as that outlined in Annex 1. The current definition of primary liquid assets may prove problematic for some IORPs and could work against prudent investment principles. For example:
  - Pooled money market funds may include cash-like instruments, such as commercial paper or reverse repurchase agreements, which do not clearly fall within the definition of ‘cash at bank.’
  - Certain bonds, such as Irish inflation-linked bonds issued via private placements, may technically qualify as ‘primary liquidity’ under current definitions but cannot be readily sold in practice.

Buffers should also account for the trading timelines of the underlying assets, ensuring that they can be realised over very short timeframes if needed. Applying appropriate haircuts to these assets, calibrated to potential value losses under severe yet plausible stress conditions, could further enhance the reliability of the buffer.

2. *Quantifying Liquidity Needs:* Our members have noted that effective liquidity management requires IORPs to distinguish between liquidity needs met by existing high-quality liquid assets (HQLA), such as government bonds that can be readily sold or repoed, and those requiring additional liquidity buffers. Additionally, risk measures used to define buffer sizes should be clearly mandated to avoid an overreliance on elective or discretionary stress scenarios that could reduce the severity of anticipated stresses. This would support a consistent and reliable approach to buffer calibration, thereby strengthening overall liquidity management.
3. *Minimum Liquidity Buffer for Operational Needs:* We agree that a certain liquidity buffer of cash or cash-equivalent assets is prudent for IORPs, providing a safeguard against unexpected liquidity needs. However, it is noted that the buffer should not necessarily be calibrated to cover the most extreme stress scenarios, as this could result in an excessive allocation to highly liquid, low-yield assets, potentially undermining the IORP’s investment performance. Instead, IORPs may structure their buffers to meet a reasonable level of stress while preserving the flexibility to pursue long-term returns.
4. *Consideration of Contagion Risk:* Our members emphasised the importance of acknowledging potential contagion effects in buffer planning, particularly during widespread market stress where multiple IORPs may sell similar assets. IORPs should

remain mindful of the risks associated with such scenarios, as illustrated by the UK gilts crisis, where simultaneous asset sales exacerbated price drops and systemic stress.

5. *Alignment with Risk Tolerance and Expected Impact:* As with other risk categories, the appropriate size and composition of a liquidity buffer should align with the IORP's overall risk tolerance and the statistical distribution of expected liquidity events. Buffer levels (or even haircut values) may be calibrated to meet the expected liquidity needs, using an approach that reflects the stochastic distribution of such events, rather than arbitrary or overly conservative metrics (e.g., referring to percentiles of the distribution).

Q12: Do you agree that IORPs with material liquidity risk exposures should periodically test their liquidity contingency plan through simulation exercises in order to ensure operational readiness, Page 16/51 as expected in paragraphs 3.24-3.26? Please explain and provide any suggestions on the conditions imposed on the periodical testing.

The AAE offers a nuanced view on whether IORPs with material liquidity exposures should conduct simulation exercises to test their liquidity contingency plans. Our members believe that while such testing could be beneficial in certain cases, it should be applied selectively based on each IORP's risk profile and leverage level.

1. *Selective Application of Simulation Exercises:* We would suggest that simulation exercises should be conditional on the results of prior stress tests, particularly for IORPs with higher leverage. Simulation exercises could represent a significant undertaking, involving multiple parties and stakeholders. By focusing only on IORPs with significant leverage or material liquidity risk, resources can be allocated more effectively, in line with proportionality principles.
2. *Focus on Governance and Operational Readiness:* Where simulation exercises are deemed appropriate, these may focus on identifying any operational or governance bottlenecks that could impact the execution of a liquidity contingency plan. This may include practical considerations such as obtaining necessary authorisations for disinvestment, identifying timing constraints, and ensuring that all relevant processes are in place for rapid response during a liquidity event. These exercises could target practical challenges, such as obtaining signatories for disinvestments or addressing timing constraints, enhancing operational readiness without overextending resources.
3. *Legal and Structural Considerations:* Our members also recommend that simulation exercises, where applied, assess the legal structures of funds held by the IORP, including any anti-dilution levies, gating provisions, or constraints on investment managers' powers. For example, in cases where an LDI manager has the authority to adjust interest rate or inflation exposure, simulation exercises could evaluate how effectively these powers can be exercised under stressed conditions. This added layer of assessment would ensure that the IORP's legal and operational frameworks are fully aligned to support liquidity needs during adverse events.
4. *Review Frequency and Role of the Risk Management Function:* Our members also noted that liquidity contingency planning is part of the broader risk management system, which undergoes regular reviews. The risk management function should assess when additional, intermediary reviews are required based on changes in specific risk exposures. This would provide a structured approach, ensuring that liquidity planning remains aligned with evolving risk conditions and supports timely intervention when necessary.

Q13: To prevent operational lags in fulfilling margin requirements, do you agree that IORPs should ensure that investment funds to which IORPs have outsourced the management of derivative instruments should hold sufficient buffers of liquid assets to cover margin calls in times of market stress? Should this apply to all outsourced derivative arrangements or only a specific subset, considering for example segregated accounts/mandates versus multi-client/pooled funds and AIF versus UCITS funds? Please explain.

The AAE broadly agrees that IORPs should fully assess the liquidity characteristics and resilience of investment funds, particularly those involving derivatives or leveraged strategies, under conditions of market stress. Our members emphasised the importance of understanding potential liquidity needs associated with these investments and provided recommendations for ensuring that the IORP's risk tolerance and governance align with these liquidity risks.

1. *Integration of Fund Resilience in Risk Assessment:* Members agree that the resilience of an investment fund, including its capacity to withstand liquidity stresses, should be incorporated into the IORP's broader risk assessment process. If an investment fund's buffers or liquidity provisions are insufficient, the IORP should re-evaluate the risk involved in that investment and ensure it aligns with the scheme's overall risk tolerance. This practice applies to all types of funds, including both pooled and segregated structures, with consideration for whether specific investment characteristics meet the IORP's strategic needs and risk profile.
2. *Awareness of Potential Liquidity Calls:* Our members highlighted the need for IORPs to be fully informed about any potential liquidity demands from their investments. This includes understanding if an investment fund could require additional "capital injections" or "liquidity injections" under stress conditions. For example, funds with leveraged LDI strategies, which may rely on additional funding under certain market conditions, should disclose these potential requirements to IORPs. Some of our members suggested that only a specific subset of funds using derivatives should be included in this requirement, focusing on those with the ability to request collateral or margin from the IORP. For instance, pooled equity funds using FX forwards for hedging without such a mechanism could reasonably be excluded, whereas LDI funds capable of requesting collateral should be in scope. This distinction would ensure proportionality in liquidity risk assessments.
3. *Consideration of Investment Fund Structure and Governance:* Our members noted distinctions between pooled and segregated fund mandates in terms of control over liquidity. While IORPs set specific guidelines for segregated mandates, they have less control over pooled funds managed according to broader mandates set by the fund manager. In multi-client pooled funds, investment managers determine objectives and collateral processes, limiting the IORP's influence. Conversely, in single-client segregated funds, where the IORP sets objectives and influences collateral policies, it is reasonable to expect IORPs to ensure sufficient liquid assets are held. This reflects the differing responsibilities and governance structures inherent to these fund types.
4. *Potential Regulatory Considerations for Leveraged Funds:* Our members suggested that regulators, including EIOPA and NCAs, may wish to assess the appropriateness of IORPs investing in highly leveraged funds, given the liquidity risks these can introduce. Our members also recommended that regulatory definitions of "market stress" be refined. For example, rather than using scenarios like the UK gilt crisis as a baseline, stress parameters could draw on historical short-term movements in Euro interest rate and

inflation swap rates, referencing prudent percentiles of the distribution. This adjustment recognises structural differences in markets and avoids unnecessary conservatism in liquidity risk planning.

5. *Implementation of Enhanced Buffers for Pooled Funds:* In line with recent regulatory guidance, LDI managers of pooled funds have increased their buffers of liquid assets within and alongside these funds to cover capital calls. This demonstrates an industry-wide adaptation to address liquidity challenges effectively in such fund structures.

Q14: Do the expectations put forward in the draft Opinion achieve a proportionate approach to liquidity risk management of IORPs? If not, please provide your suggestions to improve proportionality of the draft Opinion.

The AAE broadly agrees with the approach outlined in the draft opinion. Our members have provided the following observations to refine and support the approach:

1. *Proportionality in Risk Management:* Proportionality should not be solely linked to the size or volume of an IORP but rather to its risk profile. Smaller IORPs with high liquidity risks could pose risks comparable to larger IORPs with similar profiles. Proportionality must be assessed as the balance between the risk taken and the capacity of the risk taker.
2. *Concerns About Simulation Exercises:* The proposed “simulation exercise” to test liquidity contingency plans could be seen as disproportionate. If an IORP maintains a robust, documented, and up-to-date liquidity contingency plan with appropriate stress testing, the additional burden of a simulation exercise may not justify its costs, including stakeholder time, effort, and advisory fees. A more proportionate approach could focus on enhancing existing practices rather than adding potentially onerous requirements.
3. *Support for Risk-Based Application:* A risk-based, proportionate approach to liquidity risk management aligns with the objectives of the IORP II Directive. However, specific measures such as simulation exercises and proportionality frameworks require careful calibration to avoid unnecessary costs while achieving effective risk management outcomes.
4. *Inclusion of Liquidity Risk Sources:* Incorporating the sources of liquidity risk outlined in the response to Q5 into paragraph 3.6 of the consultation document would provide a more comprehensive view of potential liquidity risks and their management within IORPs.
5. *Margin and collateral calls as liquidity risk source:* The use of derivative instruments which could lead to margin and collateral calls may differ from country to country but also between IORPs in the same country. Where the risk is non-material, IORPs should not be burdened with additional reporting requirements causing higher costs and allocation of internal resources.

Q15: Do you agree that the Impact Assessment in Annex I provides a balanced view of the costs and benefits of the relevant policy issues in the draft Opinion? Please explain and provide any suggestions.

The AAE acknowledges the analysis and conclusions presented in the Impact Assessment and appreciates the balanced consideration of the costs and benefits of the proposed policy measures.

Our members agree that the Impact Assessment provides a balanced and comprehensive view of the costs and benefits associated with the proposed measures. They appreciate the nuanced consideration of the implications for IORPs and recognise that the analysis effectively supports the policy conclusions presented.

Our members also believe that liquidity risk should be integrated at the same level as other risk categories within an IORP's overall risk management system. This approach would ensure that liquidity risks are considered systematically and proportionately alongside other significant risks, aligning with best practices in risk governance.

Q16: Do you have any other comments on the draft Opinion / consultation paper? If yes, please provide these other comments?

We have the following additional comments:

1. Our members highlighted that liquidity risk varies significantly between defined contribution (DC) and defined benefit (DB) pension schemes, as well as between schemes at different stages of maturity (e.g., young vs mature schemes). These differences affect liquidity risk profiles, indicators, risk tolerances, and triggers. While our members did not advocate for tailored guidance for each scheme type, they recommend that EIOPA provide principles-based guidance that acknowledges these variations.
2. Our members expressed concerns about the expectation that NCAs assess liquidity risk management for outsourced activities. The ability of NCAs to supervise outsourced providers may vary depending on their powers and the definition of outsourcing. This requirement should be clarified and supported with practical guidance to ensure feasible implementation. The principle of proportionality should also be applied when evaluating outsourced activities to prevent undue administrative burdens.
3. Our members noted that while the consultation paper appropriately responds to recent market events, effective risk management should also focus on anticipating potential future risks rather than solely reacting to past events. Focus should be extended to principles-based risk management across the broader IORP environment and range of risks.
4. We would suggest that EIOPA and supervisors play a proactive role in fostering a strong risk management environment by developing guidelines and best practices tailored to the needs of IORPs. This would help ensure that liquidity risk management practices are implemented effectively and that risk management systems are robust, professional, and capable of protecting the interests of all stakeholders.