



In a hard-hitting response to the consultation paper on proposed changes to the EU Institutions for Occupational Retirement Provision (IORP) Directive, the ACA has joined with other business, trade unions and pension bodies in drawing a line in the sand over reforms...

ACA SAYS ADOPTION OF SOLVENCY II TYPE APPROACH TO FUNDED PENSIONS IS 'INAPPROPRIATE, UNAFFORDABLE AND UNNECESSARY'

10 January 2012 – In its response to the 500-page European Insurance and Occupational Pensions Authority (EIOPA) consultation on changes to the Institutions for Occupational Retirement Provision (IORP) Directive, the Association of Consulting Actuaries (ACA) has rejected key suggestions as being 'inappropriate, unaffordable and unnecessary'.

The EU Commission wants to address the funding of pension schemes going forward and has asked EIOPA how funding requirements should be harmonised, not whether they should be. The concern is that EIOPA might yet recommend the use of Solvency II type capital rules, designed for large, complex insurance institutions, as a model for pension funds.

Bodies such as the European Federation for Retirement Provision (EFRP) as well as the Government, business and pension bodies in the UK and elsewhere have all opposed the extension of a Solvency II type regime to pensions, but as funded pensions are not widespread across much of the EU, there is mounting concern that a majority approach could jeopardise the established arrangements in the UK. Some fear the impact of such an ill-judged decision would be the closure of yet more UK private sector defined benefit pensions where funding calls on businesses would increase substantially.

ACA International Committee Chairman, Paul Kelly, comments:

"The purpose of the IORP directive is supposed to be to create an internal market for occupational retirement provision by setting the prudent person rule and making it possible to operate across borders. The principal focus of this consultation is solvency and it therefore fails to address the real issues which are or may be preventing wider cross border activity. Solvency is not the problem here, save that the existing requirement for "full solvency" in any cross border scheme is, in many cases, an absolute barrier to wider corporate interest and activity in cross-border pensions."

The ACA response to the consultation adds:

- The level of harmonisation proposed is not appropriate or achievable, given the other tax and legislative differences that remain across the European states. If harmonisation was indeed the goal, these measures fail by excluding book reserves. Indeed, the measures will dramatically increase the disparity between a book reserve system and a funded system, to the point where logically sponsors and indeed Member States may chose to amend systems of provision so that book reserves will become dominant, which many would see as a totally inappropriate outcome.
- Rather than harmonisation for its own sake (an unworkable and unattainable ideal), better for the EU to focus on cross-border provision. The ACA says the case for massive upheaval, which a complete overhaul of the system of solvency regulation would certainly entail, has not been made. Taking the UK system for example (including protection mechanisms such as the PPF and the active role of the Pensions Regulator) there is no evidence presented that it is failing to serve consumers.
- The EIOPA consultation looks at three objectives - adequacy, security and sustainability. The ACA says importing a complex Solvency II type system onto already complex Member State systems of prudential and social regulation runs counter to and may paradoxically jeopardise the “adequacy” and “sustainability” limbs presently in place.
- The requirements are overly complex for regulating an industry that has social aims as well as financial objectives and which makes provision at a small business level. Comparability and harmonisation between insurers makes sense, because they compete in the market for business. There is no such competition between IORPs.
- The concept of “transfer value” solvency, which assumes the need to aim for a world where a (distressed) sponsor can readily transfer its IORP in full to an insurer, is misplaced and is rejected by the ACA. In practice, the UK already has the PPF, as required by long-standing EU law (article 8 of the 1980 Pensions Directive). This additional concept of transfer to an insurance company is inconsistent, unnecessary and overly onerous. Furthermore for decades it has been possible to transfer individuals, blocks of membership and indeed whole schemes from IORP to IORP. Portability is already enshrined.
- A risk free approach to interest rates is as unworkable as it is unaffordable, says the ACA, most particularly within the EU at present.
- Of the three options discussed in the EIOPA paper as regards the calculation of “best estimate” funding, Option 3, the two-tier approach, does have merit in principle, says the ACA, provided the implementation is largely left to Member States.
- Sitting alongside this two-tier approach, the “holistic balance sheet” as proposed in the EIOPA paper is, in practice, unworkable says the ACA. The difficulties with placing formal monetary value on the value of the sponsor covenant are massively understated in the consultation. Practical experience in the UK demonstrates such assessments are prone either to be hugely expensive, multi-disciplinary and time-consuming exercises, or to be shallow. Even a limited exercise such as the valuation of intangible assets such as “brand” is fraught with difficulty and subjective opinion. The ACA says there is no evidence that the current UK system of covenant assessment is so flawed as to require an EU approach to be prescribed.

- As regards DC schemes, the calculation and maintenance of a reserve to cover operational risk will add significantly to frictional costs. The logical consequence is for the sponsor to move to a contract basis where this reserve is “implicit” and is in fact paid for by members by way of lower returns, the further disadvantage that trustee oversight will be lost.
- The ACA says the supervisor’s power to set Technical Provisions should be left to Member States.

Paul Kelly added that:

“Overall, there would not be enough actuaries in Europe to begin to deal with the workload, should the complexities described in this consultation ever be visited upon us, regardless of the simple truth that a Solvency II type regime is inappropriate, unaffordable and unnecessary for pensions.”

The complete response to the EIOPA consultation on changes to the IORP Directive is available on the ACA website at www.aca.org.uk (go to: ‘Recent Publications’ on home page).

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Note for Editors

About the Association of Consulting Actuaries (ACA)

The **Association of Consulting Actuaries (ACA)** is the representative body for consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body. The ACA has 1,750 members working in around 75 firms. ACA Members are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries’ Code. The ACA forms the largest national grouping of consulting actuaries in the world.