

Feedback on the QIS:
***NAPF members' experience of
completing EIOPA's QIS on the
IORP Directive***

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Overview

EIOPA's Quantitative Impact Study (QIS) on its Holistic Balance Sheet (HBS) proposal is a crucial element in the EU's current review of the IORP Directive. EIOPA's advice to the European Commission on the drafting of a new IORP Directive is – in respect of the Holistic Balance Sheet – conditional on the outcome of the QIS. So it is important to get the QIS right.

The QIS was launched on 16th October and closed on 17th December. It required national regulators and pension schemes to complete a complex set of spreadsheets across 18 different scenarios. In the UK, the Pensions Regulator produced a simplified questionnaire that provided an alternative, simpler way for schemes to contribute to the QIS process.

This paper summarises feedback from members of the National Association of Pension Funds (NAPF) on their experience of completing the QIS or tPR's questionnaire. The paper details a series of concerns. In particular:

- The QIS timetable has been far too tight to allow adequate consideration of the very complex issues in question.
- NAPF members are concerned that the Holistic Balance Sheet would not take adequate or accurate account of the sponsoring employer's support for the scheme.
- The new Solvency Capital Requirement could introduce perverse incentives to shift investment away from assets that reduce risk or contribute to economic growth.

About the NAPF

The National Association of Pension Funds is the UK's leading voice for workplace pensions. Our members operate 1,300 pension schemes. They provide retirement income for 16 million people and have over €1 trillion of assets under management. Our membership also includes over 400 providers of essential advice and services to the pensions sector. This includes accounting firms, solicitors, fund managers, consultants and actuaries.

The NAPF is a founder member of Pensions Europe, which is chaired by the NAPF's Chief Executive, Joanne Segars.

QIS process and timetable

NAPF members were concerned that the QIS has been conducted on a very tight timetable and covers extremely complex issues. The Holistic Balance Sheet involves a series of very technical calculation methods that are completely new to UK pension schemes and their advisers.

- NAPF members could not give the figure required for Technical Provisions because they do not have the numbers on the basis required by the Holistic Balance Sheet.
- One NAPF member pension scheme pointed out it would cost around £15,000 to commission consultants to run these calculations and to do associated work. This would also take some time. Another member had already been charged £10,000 by its consultants for work on the QIS and IORP Directive review to date (in addition to substantial work by the in-house team). Furthermore, the costs of completing the HBS would be incurred every year, adding to annual scheme running costs.

“One comment I heard was ‘what’s in it for us if we do complete it?’ and it is actually a little difficult to come up with a convincing answer on this, other than ‘helping TPR!’” (pensions consultant)
- The tight timescale provided very little flexibility. In cases where schemes were busy with other tasks, such as valuations or rule changes, there was no spare capacity for completing the QIS in the 8 weeks available.
- Long term nature of DB pension schemes is not taken fully into account by the HBS.

“I am sorry, we were unable to complete this questionnaire on time. It coincided with a valuation, an asset guideline review and a change of CFO.” (scheme manager)
- The pan-European assumptions employed in the HBS for inflation (2%), discount rates (swaps less 35bp), default rates (50%) and ultimate forward rates (4.2%) would give inaccurate answers.
- The date of calculation for the QIS is 31 December 2011. This ‘snap shot’ approach to valuation risks giving an unreliable picture of a scheme’s underlying strength. In the UK, the Government has recognised that this difficulty is exacerbated by the impact of Quantitative Easing, which has depressed gilt yields and, therefore increased pension scheme liabilities and deficits. The Government recently announced (in its Autumn Statement on 5th December) that it will consult on ways of helping schemes through this temporary difficulty. Those drawing up plans for the Holistic Balance Sheet should draw on this experience.

“We don’t have any clients who completed either the full QIS or TPR’s questionnaire, which I think tells a story in itself.” (pensions consultant)
- The Holistic Balance Sheet relies excessively on credit rating agencies to calculate the bond portfolio risk as well as the sponsor support.
- Many schemes – particularly those sponsored by listed companies, were unwilling to complete the QIS for reasons of commercial sensitivity. Assigning a new figure to pension scheme funding – particularly if it were to show a larger deficit – could have an immediate adverse impact on the share price.

Sponsor support

Putting an accurate value on sponsor support will be essential if the Holistic Balance Sheet is to give a credible assessment of the overall strength of the scheme. This is particularly sensitive and important for schemes (typically long-established schemes sponsored by large corporates) where the pension scheme is very large in relation to the sponsor.

- It is acknowledged that the QIS *could* 'put a number' on sponsor support, but it is not clear that it would be the correct number. EU policy-makers should give the industry time to develop a solution to the challenge of putting a specific value on sponsor support. After all, no one has ever attempted to do this.
- Some larger sponsors have a complex corporate structure, often including overseas parent or subsidiary companies. It is not clear whether the HBS would take full account of this. For example, if the UK business were to be adversely affected by weak economic conditions in the UK, other parts of the company might still perform strongly. Would this be reflected in the HBS?
- The Holistic Balance Sheet provides no consideration for non-corporate schemes (eg in the third sector), where sponsors will not have formal credit ratings.
- Some schemes have spent time developing a bespoke approach to valuation with their national supervisor, yet the QIS proposes a single calculation based on specific default and recovery rate assumptions, credit agency ratings and "sponsor's expected cashflow to year d (where d is average life of liabilities). Although the Holistic Balance Sheet might allow comparability between schemes and across member States, it is not clear that it will give a more accurate assessment of the strength of the scheme than is already available.

"Employer support for the scheme is a subjective assessment carried out by the Trustee using their appointed covenant advisors. No capital value has ever been placed on the sponsor support." (scheme manager)
- One large multi-employer IORP commented that it had had to use sector-wide information in order to complete the QIS, as information on its 300-plus sponsoring organisations was not available in the form required. This information will be – at best – an approximation to the actual situation of the scheme sponsors.
- There is no provision in the Holistic Balance Sheet for employers that support more than one IORP.
- The QIS does not permit schemes to use the results of risk management work undertaken by in-house teams. Although only large schemes have the resource for this kind of in-house work, the QIS should be sufficiently flexible to make use of it where it is available.
- The Holistic Balance Sheet does not acknowledge that the support provided by sponsors that have been in existence for many decades (or even centuries) is likely to be stronger – in general – than for other organisations.

- The UK has a preponderance of multi-employer schemes (both associated and non-associated), many established on a ‘last man standing’ basis. The Holistic Balance Sheet does not take account of the distinctive dynamics of this kind of scheme.

Solvency Capital Requirement

The Solvency Capital Requirement attempts to quantify a series of risks and – potentially – would add a significant extra element to scheme liabilities as measured by the Holistic Balance Sheet. Yet many of the values assigned to these risks are arbitrary. In some cases, they would provide perverse incentives for schemes to shift investments away from the areas where the economy most needs extra capital, such as infrastructure, or away from instruments that can be used to hedge and reduce risk, such as some derivatives.

- Immature schemes (those still open to new members or with high numbers of active members) would be unfairly penalised with a high SCR, due to their sizeable allocations to equity, hedge funds and property and low allocations to bonds.
- This factor would have profound implications for asset allocation – and huge ramifications for the investment markets in general.
- The section of the Holistic Balance Sheet on bond risk is very detailed and involves a detailed calculation whereas the equity section is very simplistic.
- The SCR system effectively assumes that anything that is not a bond is an equity. This penalises schemes that have used alternatives for the purpose of de-risking and will artificially increase the risk numbers in the SCR.
- Schemes will be further penalised through the SCR by the assumption that EEA government bonds are risk free and non-EEA bonds are not.
- Infrastructure allocations are deemed as “other” and will be rated as such (49% capital requirement). Again, this is out of kilter with the encouragement many governments are giving pension schemes to invest in infrastructure in order to stimulate the EU economy and to provide new streams of long-term, relatively low-risk investment.

“The cross European assumptions on inflation (2%), discount rates (swaps less 35bp) and default rates (50%), ultimate forward rates (4.2%) will give inaccurate answers.” (Policy Director – large scheme)

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