



Policy Department

CONFIDENTIAL

DRAFT

15 February 2019

DRAFT OPINION OF THE EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY

of [date Month YYYY]

on the Practical Implementation of the Common Framework for Risk Assessment and
Transparency for IORPs

1. Legal basis and scope

- 1.1. The European Insurance and Occupational Pensions Authority (EIOPA) provides this Opinion on the basis of Article 29 on Common supervisory culture of Regulation (EU) No 1094/2010¹ (hereafter the 'EIOPA Regulation'). This Article mandates EIOPA to play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union by providing opinions to competent authorities. In addition, the Article permits EIOPA to develop new practical instruments and convergence tools to promote common supervisory approaches and practices.
- 1.2. EIOPA delivers this Opinion in the context of risk management by IORPs, and more specifically Articles 25, 28 and 49 of Directive (EU) 2016/2341² (hereafter the 'IORP II Directive'). Article 25 on risk management requires IORPs to have in place an effective risk-management function and system in a manner that is proportionate to their size and internal organisation, as well as to the size, nature, scale and complexity of their activities. IORPs must have strategies, processes and reporting procedures in place to identify, measure, monitor, manage and report within the IORP on risks. Article 28 on Own-risk assessment requires IORPs, in a proportionate manner, to carry out and document their own-risk assessment, including an assessment of the effectiveness of the risk-management system. Article 49 on Supervisory review process empowers competent authorities to review the strategies, processes and reporting procedures which are established by IORPs [...], taking into account the size, nature, scale and complexity of the activities of the IORP, including an assessment of the risks the IORP faces. In addition, Article 49 ensures that competent authorities have monitoring tools,

¹ Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (OJ L 331, 15.12.2010, p. 48).

² Directive (EU) 2016/2341 of the European Parliament and of the Council of 14 December 2016 on the activities and supervision of institutions for occupational retirement provision (IORPs) (recast).

including stress-tests, that enable them to identify deteriorating financial conditions in an IORP and to monitor how deterioration is remedied.

- 1.3. The IORP II Directive entered into force on 12 January 2017 and Member States had to transpose this into national law by 13 January 2019. A review of the Directive is foreseen 13 January 2023.³
- 1.4. This Opinion concerns the practical implementation of the common framework for risk assessment and transparency for IORPs⁴ providing occupational pension schemes in which risks are shared to differing degrees between the sponsor, plan members and the institution itself. IORPs providing pure DC schemes, in which risks are directly and fully borne by the plan members, are not within the scope.
- 1.5. This Opinion is addressed to the competent authorities (NCAs), as defined in point (i) of Article 4(2) of the EIOPA Regulation.
- 1.6. The Board of Supervisors has adopted this Opinion in accordance with Article 2(7) of its Rules of Procedure⁵.

2. Context and objective

- 2.1. On 14 April 2016 EIOPA delivered its Opinion on a common framework for risk assessment and transparency for IORPs to the EU institutions to strengthen EU prudential regulation of IORPs.
- 2.2. This framework is relevant for all IORPs providing occupational pension schemes in which risks are shared to differing degrees between the sponsor, plan members and the institution itself. IORPs providing pure DC schemes, in which risks are directly and fully borne by the plan members, are not within its scope.
- 2.3. Under the common framework, IORPs have to perform a standardised risk assessment (SRA), calculating the impact of pre-defined stress scenarios on a market-consistent balance sheet, including all available security and benefit adjustment mechanisms, such as sponsor support, pension protection schemes and benefit reductions. The Opinion to the EU institutions advised that the outcomes of the SRA should be publicly disclosed and that competent authorities should be provided with sufficient powers to act in response to the conclusions of the SRA. In order to minimise the burden on small- and medium-sized IORPs, the Opinion to the EU institutions recommended that the common framework should be applied in a proportionate manner by allowing for simplified methods and approaches, providing the possibility to exempt small IORPs and to lower the frequency of calculation from annually to once every three years.
- 2.4. EIOPA considered in its Opinion to the EU institutions that the introduction of the common framework would be beneficial in supplementing the national regulatory frameworks. The common framework would ensure an objective and transparent view of the financial position of IORPs by valuing all assets and liabilities on a market-consistent basis, both at the reference date and following the application of the SRA. By including all security and benefit adjustment mechanisms, the common framework would also provide a comprehensive view of the extent to which pension promises are supported by financial

³ Recital 75 and Art. 62 of IORP II Directive (EU) 2016/2341.

⁴ In accordance with EIOPA, Opinion to EU Institutions on a Common Framework for Risk Assessment and Transparency for IORPs, EIOPA-BoS-16/075, 14 April 2016, available at: [https://eiopa.europa.eu/Publications/Opinions/EIOPA-BoS-16-075-Opinion to EU Institutions Common Framework IORPs.pdf](https://eiopa.europa.eu/Publications/Opinions/EIOPA-BoS-16-075-Opinion%20to%20EU%20Institutions%20Common%20Framework%20IORPs.pdf)

⁵ Decision adopting the Rules of Procedure of EIOPA's Board of Supervisors, available at: https://eiopa.europa.eu/Publications/Administrative/EIOPA-BoS-11-002_EIOPA-BoS-Rules%20of%20Procedure-Rev3.f.pdf.

assets and the extent to which they rely on sponsor support, pension protection schemes and benefit reductions.

- 2.5. The information provided by the common framework would allow for a better understanding of the risks and vulnerabilities of IORPs, contributing to their resilience and sustainability and improving the protection of members and beneficiaries. The introduction of a “common language” for valuing assets and liabilities and measuring risks would improve the functioning of the internal market by facilitating supervisory coordination relating to cross-border activity of IORPs, detecting and preventing regulatory arbitrage, promoting equal conditions of competition and increasing cross-sectoral regulatory consistency between the IORP Directive and the insurance framework.
- 2.6. EIOPA already puts into practice elements of the common framework through its biennial stress tests of the European IORPs sector. In particular, the occupational pensions stress tests assess the impact of adverse scenarios on the common framework’s balance sheet of IORPs providing DB/hybrid pension schemes.⁶
- 2.7. The objective of this opinion addressed to the NCAs is to foster the practical implementation of the common framework at the national level, in order to promote a common supervisory culture and consistent supervisory practices as well as to contribute to capturing the aforementioned benefits of the common framework. In addition, the common framework will assist IORPs and the national NCAs by providing a market-consistent and risk-sensitive tool for respectively the own-risk assessment and the supervisory review process. Finally, the use of the common framework at both national and European level (through the EIOPA stress tests) will mutually reinforce one another in terms of interpretation of the results and practicability of the calculations.
- 2.8. To allow for the practical implementation of the common framework, this opinion will be accompanied by:
 - Principles and technical specifications for IORPs to value the common framework’s balance sheet and perform the SRA calculations. To that end, EIOPA has translated the high-level description of the common framework in the Opinion to the EU institutions into more specific technical specifications and where possible simplifications, building on the technical specifications for the valuation of the common balance sheet in the IORP stress tests⁷ and for the quantitative assessment of further work on solvency of IORPs⁸;
 - A spreadsheet that will be published in due course on the EIOPA website containing the risk-free interest rate and inflation curves for the relevant currencies end-2018, as well as the stressed interest rate and inflation curves for the purpose of the SRA interest rate risk module. EIOPA will update this file every year.
 - A quantitative reporting spreadsheet, also assisting IORPs in doing part of the calculations;

3. Taking the above into consideration, EIOPA is of the opinion that

⁶ See EIOPA, IORPs Stress Test Report 2015, 26 January 2016, EIOPA, 2017 IORP Stress Test Report, EIOPA-BoS-17/370, 13 December 2017 and EIOPA, IORP Stress Test 2019 Specifications, EIOPA-BoS-19/xxx, xx March/April 2019.

⁷ See EIOPA, Annex to IORP Stress Test 2017 Specifications – Technical Specifications Common Balance Sheet, EIOPA-BoS-17/076v2, 18 May 2017. [Mid-2019 the technical specifications for the 2019 IORP ST can be referenced]

⁸ See EIOPA, Technical Specifications – Quantitative Assessment of Further Work on Solvency of IORPs, EIOPA-BoS-15/070v2, 11 May 2015.

1. NCAs SHOULD INDICATE TO IORPs THE AVAILABILITY OF THE COMMON FRAMEWORK AS A TOOL FOR RISK ASSESSMENT AND SHOULD STAND READY TO SUPPORT IORPs IN THE APPLICATION OF THIS TOOL

- 3.1. The common framework consists of a market-consistent common balance sheet and a standardised risk assessment. The elements on the balance sheet are valued using the basic risk-free interest rate and recognises all available security and benefit adjustment mechanisms, including sponsor support, pension protection schemes, conditional and discretionary benefits and benefit reduction mechanisms. The common framework allows for the use of simplifications for reasons of proportionality (see further section 4), although it is acknowledged that this will result in deviations from a fully elaborate method to value the common balance sheet.
- 3.2. Irrespective of the national framework in which IORPs operate, the use of the common balance sheet will as such provide important information for IORPs for risk management purposes, f.i. what would be their funding position if they would fully derisk, or how much funding is needed to buy out the IORP.
- 3.3. The standardised risk assessment analyses the impact of a set of common, pre-defined stress scenarios on the common balance sheet and provides as such insight to what extent the IORP's excess of assets over liabilities is reduced under certain stress scenarios and to what extent security and benefit adjustment mechanisms can absorb these stress scenarios.
- 3.4. When carrying out their own-risk assessment in the context of Article 28 of the IORP II Directive, IORPs must start from the national regulatory framework in which they operate. Although the ORA is an OWN risk assessment, the information provided by the common framework, which includes all available security and benefit adjustment mechanisms, could further strengthen risk assessment and risk management, irrespective of how capital and funding requirements are defined at national level. Still, the assessment of the overall funding needs of the IORP, including a description of the recovery plan where applicable⁹, must comply with the funding requirement in the national regulatory framework.
- 3.5. As part of the ORA, IORPs should conduct a qualitative assessment of the protection mechanisms¹⁰ and assess the risks to members and beneficiaries considering any indexation mechanisms and benefit reduction mechanisms.¹¹ Under the common framework, IORPs have to establish market values for these mechanisms, if available, both in a pre- and post-stress situation. In case of sponsor support, IORPs also have to ascertain whether the value recognised on the common balance sheet is affordable for the sponsoring undertaking. It is the view of EIOPA that the market values of security and benefit adjustment mechanisms constitute valuable elements which can be used as input for the more qualitative assessment required by the IORP II Directive.
- 3.6. Besides the aforementioned national funding requirement and the qualitative assessment of security and benefit adjustment mechanisms, there are other elements required in the ORA that are not (fully) covered by the common framework. For instance, the common framework only includes operational risk¹² at an overall, quantitative level and does not consider – or at least not explicitly – ESG risks¹³.

⁹ Art. 28.2(d) of IORP II Directive (EU) 2016/2341.

¹⁰ Art. 28.2(f) of IORP II Directive (EU) 2016/2341.

¹¹ Art. 28.2(e) of IORP II Directive (EU) 2016/2341.

¹² Art. 28.2(g) of IORP II Directive (EU) 2016/2341.

¹³ Art. 28.2(h) of IORP II Directive (EU) 2016/2341.

- 3.7. EIOPA therefore refers to its guidance related ORA in [Supervisory opinion on SIPP and ORA], to its guidance related to operational risk in [Supervisory opinion on operational risk] and to its guidance related to ESG risks in [Supervisory opinion on ESG risks].

2. THE COMMON FRAMEWORK IS A TOOL WHICH, CONSIDERING THE NATIONAL SPECIFICITIES, CAN BE USED BY NCAs IN THE CONTEXT OF THE SUPERVISORY REVIEW PROCESS

- 3.8. According to Article 49 of the IORPII Directive, NCAs are required to conduct a review of the strategies, processes and reporting procedures which are established by IORPs to comply with the laws, regulations and other provisions adopted pursuant to the IORP II Directive. That review shall include among others an assessment of the risks IORPs face and of the ability of IORPs to assess and manage those risks.
- 3.9. Furthermore, NCAs should have in place monitoring tools, including stress tests, to identify deteriorating financial conditions in an IORP.
- 3.10. The standardised risk assessment embedded in the common framework allows NCAs to gather information in a standardised manner on the risk profile of IORPs, which can be used as input for developing their supervisory planning in the context of a risk-based supervisory approach.
- 3.11. The SRP is to be conducted considering the national regulatory framework in which IORPs operate. In this context, the common framework supplements national valuation and funding standards by providing a market-consistent view of the financial situation of IORPs and their reliance on security mechanisms such as sponsor support and benefit reductions.
- 3.12. The results of the common framework can provide useful information to the NCA and will help them to identify excessive risk exposures, possible weaknesses and deficiencies amongst IORPs. Where deemed appropriate, NCAs may request IORPs to consider these weaknesses and deficiencies in their risk management process.
- 3.13. According to Article 49.4 of the IORPII Directive, NCAs shall establish the minimum frequency and the scope of the supervisory review having regard to the size, nature, scale and complexity of the activities of the IORP concerned. A precondition for using the common framework in the context of the supervisory review process is the availability for NCAs of necessary data from IORPs. NCAs should therefore determine to what extent additional data needs to be reported by IORPs. EIOPA advises that NCAs set the reporting frequency in line with the national reporting requirements.

3. NCAs SHOULD ENCOURAGE IORPs TO MAKE THE RESULTS OF THE COMMON FRAMEWORK AVAILABLE TO RELEVANT STAKEHOLDERS

- 3.14. The common framework provides an explicit and objective view of all resources, such as financial assets, sponsor support and pension protection schemes, which are available to support pension obligations. Although it does not necessarily give an exact view of the expected amounts of intervention by the sponsor and pension protection schemes, it gives an indication about who might be obliged to intervene and to what extent. It also includes a useful indication of the extent to which benefit adjustments, either positive or negative, may occur in the future based on its valuation under the common framework.
- 3.15. As such, the common framework provides useful information about the extent to which not only the IORP, but other stakeholders like sponsors and pension protection schemes might be expected to contribute to fulfilling the pension obligation based on the valuation under the common framework, and the extent to which members and beneficiaries might expect to receive non-unconditional benefits or face benefit reductions.

- 3.16. The common framework enables members and beneficiaries to assess the value of their benefits on a common basis, including the potential of benefits being increased or reduced, and enables sponsors to assess the potential cost of fulfilling their pension obligations assuming that investment returns are at the risk free rate.
- 3.17. EIOPA therefore expects NCAs should encourage IORPs to make the results of the common framework available to relevant stakeholders, such as sponsors, members, NCAs, This information allows stakeholders to make informed decisions.
- 3.18. When IORPs operate several pension schemes for different groups of members and/or sponsoring employers, it could be appropriate to apply the common framework for each pension scheme separately, or for each sponsoring undertaking separately. As such, relevant information could be obtained for each of the specific stakeholders.
- 3.19. When making outcomes of the common framework transparent to stakeholders or to the national supervisor, attention should be given to describing clearly the context in which the calculations have been done, including the parameters set and the assumptions that have been used in modelling and the valuation of some items of the balance sheet such as sponsor support and reduction of benefits.

4. THE COMMON FRAMEWORK SHOULD BE APPLIED IN A PROPORTIONATE WAY ALLOWING FOR SIMPLIFICATIONS

- 3.20. For proportionality reasons, considering their size, nature, scale and complexity of their activities, the common framework includes many simplifications which should allow most IORPs to apply the common framework, even. NCAs may adopt further simplifications for the valuation of the common balance sheet when these simplifications are proportionate to the nature, scale and complexity of the underlying risk of their IORP sector.
- 3.21. Some elements of the technical specifications will not be relevant for IORPs in some member states, but have been included because they are relevant in other member states. In addition, the degree of materiality of many of the items included within the specifications will vary depending on the nature of IORPs in member states. NCAs may therefore decide to inform their IORPs which elements may be excluded.

4. Monitoring by EIOPA

- 4.1. To be drafted later.

Done at Frankfurt am Main, XX Month 2019

[signed]

Gabriel Bernardino

Chairperson

For the Board of Supervisors