

OPSG

OCCUPATIONAL PENSIONS STAKEHOLDER GROUP

**Advice on the supervision of long term risk
assessment by IORPs (Institutions for
Occupational Retirement Provision) providing
Defined Contribution schemes**

EIOPA-OPSG-21-23

16 July 2021

Q1: Do you agree with the focus of the draft Opinion on the quantitative elements in operational risk management and long-term risk assessment from the perspective of members and beneficiaries? Please explain and provide any suggestions for further aspects of DC risk management that need attention.

Yes.

Since the business of an IORP is very much long-term in nature and the consequences from risk realization for the beneficiaries are also, such risk assessment also of course to be long-term. Since in a DC product a lot of risks, which in case of a DB product are carried by the IORP (and/or the employer), are shifted towards the beneficiaries, such risk assessment has to be from the perspective of the beneficiaries. Additionally, such risk assessment should cover all kind of relevant risks and this has to include obviously also operational risks. Also, these should ideally be quantified (if reasonable and possible) and properly integrated into the whole risk assessment (please look at the answer to question 4 for any further details regarding operational risks).

However, the IORP II directive does not require a quantitative assessment of the operational risk and therefore an opinion of EIOPA on this subject goes beyond the scope of IORP II.

Furthermore, it's up to the IORP to determine if there is a need to use pension projections to complement the ongoing risk management or to use other risk management techniques which are equally suitable for the aforementioned purpose.

In some cases IORPs already perform a risk management substantially aligned with the one recommended by EIOPA.

The risk assessment should (at least) cover the full risk position from the beneficiaries' point of view and shall result out of following categories of risk, which contribute to the total risk position:

- Market risks for all the different asset classes (e.g. interest risk, equity risk, real estate risk, ...)
- Inflation risk
- Counterparty risk
- Operative (operational) risk (incl. outsourcing risk, IT-risk, Cyber-risk, leakage risk for sensitive data...)
- Cost risk (see also the paragraph regarding costs in this paper)
- Liquidity risk (if any)
- Biometrical risk (especially longevity risk, which in a DC case is usually the risk of outliving one's assets; this kind of risk might not be applicable for all DC pension plans)

While defining the guidance of the long-term risk management from the perspective of the members and beneficiaries for DC IORPs, the key difference between DB and DC IORPs has to be always considered: in general, in DC IORPs members and beneficiaries bear the risks; in DB IORPs the IORPs themselves (or the sponsor) bear the risks. The long-term risk management from the perspective of the members and beneficiaries for DC IORPs should never be interpreted, neither by

the NSAs, nor by members and beneficiaries, as a legal duty on the IORPs to take responsibility for possible losses that could arise, as is the case of DB IORPs. In DC IORPs, while the schemes manage the long-term risks of members/beneficiaries, in the end, and by definition in general, the losses are borne by members/beneficiaries. Conducting the long-term risk management from the perspective of the members and beneficiaries in the case of DC IORPs without a disclaimer on the key and defining distinction between DC and DB IORPs, risks to confuse on the real nature of DC IORPs that, in the end, could represent a real risk for members and beneficiaries.

Q2: Do you agree that Annex 2 provides a balanced view of the costs and benefits of the draft Opinion? Please explain and provide any suggestions.

Yes.

Risk assessment (and management) is one necessary key functionality for any IORP. As stated in the OPSG's position paper on Asset Liability Management (ALM) and Financial Instruments (2018) this holds both for DB schemes AND for DC schemes. For both types of occupational pension plans the respective IORP should focus on providing an adequate pension (i.e. benefit) level while incurring an acceptable level of risk, in order to sustainably finance a certain guaranteed (in case of DB) or envisaged (resp. planned or targeted in case of DC) level of present and future benefit payments. In contrast to a DB pension scheme, an IORP providing a DC pension plan usually has much less risk out of that pension plan (if there is any risk at all for the IORP except for operational risk). But the risks have not vanished – they just have been shifted from the IORP and/or the sponsor to the beneficiaries and members. Hence, also and especially in case of DC schemes the general risk structure and especially the risk of not reaching an envisaged pension target for the beneficiary has to be properly assessed. In such an assessment many characteristics of the respective DC pension plan and of the respective IORP have to be taken into account including the demographic decomposition of the population of present and future beneficiaries (in case of collective DC pension plans), regulatory requirements (if any), the actual benefit level, which could be reached given the current state of the investment portfolio and its value, the type and specifications of the respective pension product (including payout options, benefits for widows resp. widowers and orphans, investment smoothing, guaranteed returns, solidarity between members, sponsor involvement, ...), the actual investment portfolio, eventually existing options for the member to select a specific investment strategy (and possibilities to switch between such strategies) etc.. Since in general the majority of all risks is carried by the beneficiaries, such risk assessments have to be at least as accurate as in the DB case and should of course take a properly estimated or assessed risk tolerance of the members and beneficiaries into account. However, such estimation or assessment has to be done with proportionate measures on the side of the IORPs or employers. Every undue cost or effort would jeopardize the pension product and/or the willingness of employers to offer such occupational pension, which in the end definitely would not be in the interest of members and beneficiaries. So, in general the OPSG appreciates EIOPA's target, that such assessment shall be done under aspects of proportionality and that EIOPA leaves the choice

of methods in many aspects to the respective IORP. In total, the OPSG very much appreciates EIOPA's initiative to work on risk management tools not only for DB but also for DC schemes.

However, the OPSG wants to stress, that this initiative can only be a concretization of existing rules and procedures under the current IORP II directive, in which, *inter alia*, some of the features of the proposed Opinion are already addressed (i.e. operational risks in the own risk assessment, national rules for pension projections under the Pension Benefit Statement). From the OPSG's point of view this proposal is clearly not meant to give any opinion with regard to the upcoming review of the IORP II directive (Directive (EU) 2016/2341). This would be far too early from the OPSG's point of view, since in many countries the current IORP II directive has been transformed into national law quite late or even maybe incorrect, so that there is currently not enough practical and meaningful experience available.

Furthermore, it has to be mentioned, that risk assessment as such should be nothing new for DC pension plans. It is already today an integral part of any DC pension plan management and is a well exercised practice: there exists already a stress test also for DC pension plans on a pan-European level and also many kinds of own risk assessments are carried out by the IORPs already today, which give the IORP's management absolutely necessary information for steering the pension product. Any additional guidance has to take into account current existing practices in Member States in this respect.

However, in 2.3. EIOPA concludes that few member states conduct DC risk assessment in IORPs using projected retirement benefits and risk tolerance. Yet EIOPA in its opinion uses the argument of supervisory convergence to force the majority of member states also to introduce these practices. This is clearly against the objective of IORP II on minimum harmonization, neglecting the heterogeneity between different member states and IORPs and again increasing costs for a large number of IORPs. Costs that in this case will reduce the retirement income of the members and beneficiaries.

EIOPA mentions in 2.9 that a consistent supervisory approach will benefit DC members, in particular mobile workers, contributing to similar levels of protection and preventing regulatory arbitrage. This is very strange in the constellation of occupational pension schemes given that risk management, including from the perspective of the members and beneficiaries is one of the cornerstones of IORP II, where IORP II is based on a minimum harmonization.

In 2.9. apparently EIOPA finds it important to ensure cross-sectoral consistency with the PEPP regulation, which is not an objective of IORP II, but at the same time this opinion does not consider the importance and implications of national social and labour law, which is part of IORP II. Referring to recital 20 of the PEPP regulation, "a PEPP is an individual non-occupational pension product subscribed to voluntarily by a PEPP saver in view of retirement...." which fundamentally differs from an occupational pension product where individuals are mandatorily affiliated in the context of an employment and as part of compensation benefits which are defined by social partners.

Q3: Do you agree with the scope of application of the Opinion, i.e. all IORPs providing schemes where members and beneficiaries bear material risks, or should the scope of the Opinion cover only IORPs providing schemes where members and beneficiaries bear all risks? Please explain and provide any alternatives that EIOPA should consider.

Yes.

The opinion shall in general apply to all IORPs where members and beneficiaries bear material risks. However, it has to be taken into account, that there will remain a clear distinction between the DB sphere and the DC sphere. For example, for a DB product providing guaranteed benefits and some additional non-guaranteed profit participation mechanisms already very far reaching risk assessments have to be done in many European countries. Such institutions are also participating in the (non-DC-part) of EIOPA's pan-European stress-test and hence should not be covered by this DC risk assessment. In general, we have to make sure, that any kind of "in-between-product" (between DB and DC) has to do only either the prescribed risk assessments for DB plans or the ones for DC – and not both at the same time. A simple and practical criterion could be, that all IORPs/products, which do not fall under EIOPA's stress-test for DB schemes fall under the regime of a DC risk assessment.

In any case we strongly object the introduction of a new definition of DC schemes. Any scheme where the IORP or the sponsoring undertaking offer a guarantee is under all international definitions a DB plan and should continue to be considered as such. A new definition will only introduce confusion. In addition, we do not agree that the same risk management should be applied to these types of plans as the distribution of the risk between sponsor, IORP and members and beneficiaries is totally different.

Q4: Do you agree that the use of quantitative elements in operational risk assessment should be encouraged? Please explain how this could best be done in your view.

Yes.

However, no objectively derived formula can cover the phenomenon of operational risk in a fully appropriate and exhaustive manner. Hence EIOPA's suggestion that the (rough) standard approach from the Common Methodology may be used for this risk category could be one fair and pragmatic proposal, because operational risk (expressed as an amount of money) should be pretty much the same for DB and DC schemes (all else being equal). However, it is appreciated, that EIOPA thinks that also an IORP's own models may be used in order to best reflect the specificities of the operational sphere of that certain IORP. In general, the OPSG wants to give the hint, that certain parts of the operational risk (e.g. the risk for fraudulent actions of the IORP's employees) are nearly impossible to be properly quantified and that hence every quantitative assessment of operational risk has significant weaknesses. But this should not hinder the IORP to take some rough and cautiously derived risk amounts for operational risks into account. Although operational risk is

consisting out of several sub-risks as mentioned above (in the list of risks in the answer to question 1), the OPSG believes for the aforementioned reasons that it is appropriate to express operational risk in one total figure, and not in calculating separate amounts for the separate sub-risks.

Operational risks are very difficult to quantify. Any IORP should consider the operational risk. We see no difference between IORPs administering DB or DC plans. Whether it generates an additional cost for the sponsor or a reduction in benefits for the members the risk is the same as is the overall impact. Putting a number on this risk might even be dangerous as it hides the extremes. We believe in a strong qualitative risk management where the board of the IORP lists all possible operational risks and sets a priority in terms of risk mitigation based on the probability and the impact of each risk and the risk tolerance of the IORP, the sponsor, the members and beneficiaries or a combination thereof. This qualitative approach makes operational risk management much more accessible than any quantitative figure.

Furthermore, the IORP II does not set or suggest a specific methodology to quantitatively measure operational risk, as the co-legislator considered that there is not a one-size-fits-all approach able to capture the different kinds of DC arrangements across the EU. As reported by EIOPA, only three Member States already specify quantitative measures for operational risk. Encouraging all other NCAs to require IORPs to quantify operational risks would lead to increasing costs, which would in the end be transferred to members and beneficiaries with potentially limited additional benefits. Like for every measure it should be clearly shown that the additional benefits of the measure clearly outweigh any additional cost.

Q5: Are in your view the Value at Risk (VaR) formulas presented in Annex 3 helpful for better understanding the possible quantitative impact of operational risk exposures of DC IORPs? Please explain and provide any suggestions or alternatives that EIOPA should consider.

No.

The problem is, as already laid out in the answer to Question 4, that no objectively derived algebraic formula can cover the phenomenon of operational risk in a fully appropriate and exhaustive manner. Therefore, these formulas CAN be used – they may be as good and as bad as almost all other suitable approaches – but do not have to. EIOPA should stick to the previously announced willingness to give freedom to the IORPs to choose a suitable methodology, which they reasonably (!) think fits best for assessing operational risk in their specific case.

Q6: Do you agree that the risk assessment from the perspective of members and beneficiaries should include a long-term assessment using projections of future retirement income? Please explain.

Yes.

Such DC risk assessment can never be seen on a stand-alone-basis. Instead, also the level of contribution or premium payments by the employer and employees and the general design of the plan have additionally to be taken into account.

The risk assessment should (at least) cover the full risk position from the beneficiaries' point of view and shall result out of following categories of risk, which contribute to the total risk position:

- Market risks for all the different asset classes (e.g. interest risk, equity risk, real estate risk, ...)
- Inflation risk
- Counterparty risk
- Operative (operational) risk (incl. outsourcing risk, IT-risk, Cyber-risk, leakage risk for sensitive data...)
- Cost risk (see also the paragraph regarding costs in this paper)
- Liquidity risk (if any)
- Biometrical risk (especially longevity risk, which in a DC case is usually the risk of outliving one's assets; this kind of risk might not be applicable for all DC pension plans)

Of course, market risks for different asset classes have to be properly transformed into a total investment risks for different strategies (where applicable, such as e.g. lifecycle models incl. glide paths, conservative strategies (high portion of fixed income), diversified (including a medium high portion of equity, minimum guarantee strategies, dynamic strategies etc.). Operational risk should also include outsourcing risk (if applicable). Since the main (total) risk from the perspective of a beneficiary is, that he or she will receive less pension benefits than originally expected due to a realisation of risks within one or several of the aforementioned risk categories it seems to be self-evident that such assessment will have to contain long term projections how big the future pension benefits will be (and how big the deviation from the original expectation due to risk realization can be).

However, it's up to the IORP to determine if projections of future retirement income should be part of the risk assessment or if other risk management techniques, which are equally suitable, are used.

Depending on the member states the DC plan design including the investment options, investment smoothing, introduction of guarantees, etc. is often governed by the respective national social and labour law. When negotiating the plan design, the sponsor and social partners decide on the plan specifications and might be looking at projections of future retirement income and the risk tolerance of the members. It's not the competence of the IORP to question and/or evaluate the outcome of the plan design determined by the sponsor and the social partners.

The main results of the risk assessment should be disclosed to the beneficiaries in a form, which is comprehensive and easy to understand. However, this has to be done very carefully, since it has to

be avoided, that beneficiaries get a wrong understanding of their risks and may in consequence draw conclusions out of that, which are disadvantageous for them. The OPSG is very well aware of the fact, that it is a difficult balancing act to achieve simplicity to understand AND sufficiency of information at the same time and that a proper format for this in general is quite difficult to find. Since risk assessment results very much depend on the assumptions used in the assessment, some information regarding the underlying assumptions would in this case also have to be given to the beneficiaries in a simplified form. This information can e.g. be given in the context of the information given to the beneficiaries according to article 39, (1), d) (information on pension benefit projections) of the IORP II directive.

From the OPSG's point of view also biometrical risk, especially longevity risk, needs to be included into such a risk assessment from the beneficiaries' point of view, in the case of DC schemes offering protection against this type of risk. In such a case, the risk that the IORP would not manage to sufficiently protect members against the respective biometrical risks and the resulting consequences for them would have to be assessed. However, in a DC scheme, which does not offer such protection, biometrical risks are not relevant for the IORP itself, but only for the beneficiaries, who carry in the end the longevity risk completely in these circumstances. As a consequence, they should be well informed, what this risk really means from their point of view. However, in these cases (where usually only a certain amount depending especially on the IORP's investment results is paid out as a lump-sum to the respective beneficiary), the biometrical risk for the beneficiary (expressed e.g. as a potential reduction in percent of the expected average amount per year, which he/she can spend for living out of the received lump-sum payment until death) is not IORP-specific any more (and hence needs not to be calculated by the IORP). Therefore, the OPSG proposes, that the beneficiary might be informed about this kind of risk by another institution than the IORP. EIOPA or the relevant NCA could e.g. take over that task by publishing e.g. on their homepage this general (not IORP-specific) assessment for different age classes of beneficiaries in order to show, what living longer than expected means for the beneficiaries' disposable money for covering costs of living. This would also be in line with article 28, (2), e) of the IORP II directive (Directive (EU) 2016/2341).

Q7: In your view, what are the potential benefits and limitations of using pension projections for long-term risk assessment in the context of DC-based pension schemes that are prevalent in the EU Member States or your Member State? Please explain and provide any alternative methods that should be considered.

In Germany there are almost no DC pension schemes. The reason is, that only since 2018 it is possible in Germany to offer a pure DC product – but only if the social partners (worker's

representatives / unions and employer) agree on the concrete terms. In practice, until today, there is only one such product being implemented. So, all in all there is no huge practical experience in Germany available for pure DC products. (However, in case of DB and hybrid products German IORPs publish pension projections for three different scenarios – optimistic, realistic and pessimistic – according to the requirements of the IORP II directive.

In Italy, NCA already requests a long-term risk assessment from the perspective of members and beneficiaries basically aligned to the one backed by EIOPA. When defining the number of investment lines available for members, their risk/return profile and their investment strategies, the IORPs have to take into account the socio-demographic characteristics of the eligible workforce and its retirement needs (adequacy of the income at retirement). The investment strategies of the lines are assessed every three years (or less, if needed) and are clearly explained in the SIPP as well as in the pre-contractual documentation. Right now, the SIPP is publicly available on the web site of the IORPs. The SIPP has to report the expected yearly average return (gross and net) and its volatility for the investment horizon of the options. It is also reported the probability of not reaching the planned or targeted benefit payment (shortfall probability). To define the risk/return profile of the investment lines the current members are in general used as a proxy, data from the first pillar are usually derived from social security database. Market and labor variables are considered for the projections. No specific model is suggested and IORPs are free to define their own models (deterministic or stochastic).

In the Netherlands a large majority of pension schemes is seen as Defined Benefit (DB). Even in the many situations where the contribution is fixed, the sponsoring companies have no obligation to pay additional contributions and the members and beneficiaries bear the risk of no indexation or reduction of pensions, the risk management is largely as what is required for DB schemes. In the near future all those schemes will move forward as DC schemes based on the recent national agreement on pensions in The Netherlands where future accrual is always in a DC scheme. A choice is offered between two types of DC schemes. One type is a pure DC scheme based on individual accounts. The other type is DC with to some extent collective risk sharing. This risk sharing is amongst the members and not with the sponsoring companies nor with the IORP. The basis for risk assessment is the risk appetite of the members and beneficiaries. This needs to be assessed on a regular basis (e.g. every three years). Another part of the risk assessment is based on the choices the members can make. They can choose to buy an annuity at retirement or opt for a draw down approach. Risk management requires to collect information from the members starting at ten years before retirement about which option has their preference in the pay-out phase. In case of an annuity the investments (often life cycling) will in the last ten years gradually move to a mix that mirrors as good as possible the price to buy an annuity (mostly bonds when reaching the retirement age with a duration close to the expected remaining lifetime). If the draw down option is preferred the investment mix will keep a longer term focus (more equities, less bonds). So, in The Netherlands it is quite important to have a good dialogue with the members in order to adequately manage the risks that meet their wishes.

In Ireland it has been a requirement for many years now to provide members of IORPs with an annual Statement of Reasonable Projection. This illustrates the benefits they are likely to receive

both if they continue as a member until retirement or if they were to cease membership today. The projection shows the fund value at retirement and the annuity that would purchase, also in today's value. The Regulator sets out the parameters for the assumptions used. The purpose is primarily for the members to understand their likely retirement benefits and also to consider whether they should take action like increasing contributions or changing their investment funds. It is common for most schemes to adopt a lifestyling approach. However this is being reconsidered by some schemes as many members do not now purchase annuities at retirement but transfer to a drawdown product so will likely continue to invest post-retirement. It can be difficult for a scheme to undertake a wider risk assessment as there is a lot of information about the members that they will not have, such as other pension savings from previous employers and other savings or wealth.

In Malta employer sponsored schemes only just started to be offered since tax relief has been available only in the last two years. The choice of funds is in the hands of the beneficiaries and as far as I am aware there are no mandated regular reviews. In fact, these are basically unit-linked policies. The payout is a cash lump sum and an annuity and no other choices. There are no DB schemes.

Q8: Could you provide information on the use in practice of pension projections for the purpose of risk management and/or the design of investment strategies (e.g. in Europe, your country or within your IORP)? If yes, please provide this information.

See answer to previous question.

Q9: Do the principles for conducting projections of future retirement income strike the right balance between setting sensible minimum standards and recognising the specificities of DC schemes in the various Member States? If not, please explain your suggestions to make the principles more or less specific and/or to add or remove principles.

No.

EIOPA should not propose one single model or preferred methodology but should propose more general principles instead. This is from the OPSG's point of view the most reasonable approach given the huge differences between the single IORP's, their setup and their legal framework in different European countries as well as the needed flexibility to propose innovative efficient DC plans in particular to address the long-standing on-going nearly zero interest rate environment. Given the many different type of DC pension plans a "one size fits all approach" can never work. Even if EIOPA has designed its own stochastic model for the PEPP, EIOPA must clearly remind that this model does not aim to become a "de-facto" standard for DC risk assessment and that each DC plan provider could use its own stochastic model. It is also adequate under aspects of proportionality, that IORPs (especially smaller ones) may use deterministic models working with some fixed pre-defined scenarios. However, it is true, that in general stochastic models give a

deeper insight into the risk situation, although their results may be much more difficult to understand and to interpret, especially for members and beneficiaries.

Q10: Do you agree with the content of the below principles, as put forward in paragraphs 3.14-3.28 of the draft Opinion:

- Stochastic scenarios of asset returns;
- Market-sensitive and realistic assumptions;
- Characteristics of members and beneficiaries;
- Pension scheme characteristics;

- Target variables and risk & performance indicators?

If not, please provide your suggestions to improve the principles.

Answers to the single tick boxes: no; yes; yes; yes; yes.

Please also refer to the explanation in the answer of question 9. Additionally, the OPSG wants to make the following comments:

EIOPA proposes to use market data, which is of course reasonable. EIOPA also proposes not to use any kind of mean reversion assumptions in the stochastic (or deterministic) scenarios. However, the OPSG proposes that EIOPA should think about using some kind of reversion towards (national) economic long-term equilibrium risk free yields (e.g. from quantity theory) but not based on its Ultimate Forward Rate (UFR) as mentioned during the PEPP discussions. We have strong reservation on the use of the UFR (published at 3,6% for 2021) as a proxy of forward risk free rates for pension products and schemes. It is from the OPSG's point of view quite important to take also such longer-term convergency phenomena into account and not to focus only on actual market conditions or short-term developments. Depending on the respective market phase this would give either a too conservative or a too optimistic view on the risk situation, both of which is not desirable and would be misleading for plan members.

Of course, assumptions used in the (deterministic or stochastic) model must be realistic, just as EIOPA stated rightly. This is especially true for capital markets related data. However, since it is not reasonable to have only one single model (which is appreciated by the OPSG as said before), also the type of assumptions and input parameters will be different in the different models applied. This will clearly make it more difficult to compare different outcomes and results stemming from the different models. However, in almost all models long-term return assumptions (stochastic expected values in case of stochastic models) for the different asset classes as well as for the risk of these asset classes and for the interdependency-relations between all of them will be needed. Regarding

the last category of input data, stochastic models using a multivariate normal distribution assumption will have to use correlation assumptions between the returns (stochastic variables) of the different asset classes, whereas other stochastic models will work with certain assumed copulas describing such interdependencies. In case of deterministic models such assumptions regarding interdependencies might be used more implicitly when developing different deterministic scenarios to be applied. This makes it from the OPSG's point of view impossible for EIOPA to issue very concrete requirements regarding the assumptions to be used. However, also here EIOPA could think about issuing certain abstract principles ensuring some kind of "minimum quality" of the assumptions used. Such principles might be for example:

- Assumed risks for single asset classes should be based on statistical data derived from a long-term historic observation period (e.g. between 5 and 10 years)
- Assumptions regarding interdependencies should also be based on such long-term historic observations or should at least be consistent what could be observed in a longer historic period (backwards from now)
- Long term return assumptions should be in line with general market consensus
- etc.

NCA's could then supervise the respective IORPs in the single member states in order to make sure, that these abstract principles are obeyed to. This would require a sufficient model description and documentation as well as transparency about the assumptions used by the IORP.

Q11: The supervisory expectations recognise and allow different methods to establish the risk tolerance of DC members and beneficiaries. Do you agree or would you propose more specific guidance? Please explain and provide any suggestion.

Yes.

Since the members and beneficiaries carry the whole (or at least a very significant part of the) investment risk, any kind of risk assessment for DC schemes has to assess risk from the point of view of the beneficiaries. Hence it is helpful, that the IORP develops a general feeling for the risk tolerance of that population and takes this into account accordingly paying attention to the characteristics of the supplementary DC pension plan. This is especially true if the IORP defines a default investment strategy which will be applied for an individual member, if this member takes no active decision in favour of a certain different investment strategy offered by the IORP (if possible). However, it has to be clear that to a certain degree this may also depend on the "stomach feeling" of the IORP and/or NCA's, since an objective scientific methodology for measuring such risk tolerance of members is generally not available. Asking the individual members about their risk tolerance (e.g. how much pension cuts they are willing to accept, if things go bad) can be problematic, because many people may not be able really to understand this issue to an extent which would be necessary to take a really informed decision and to give a sound answer. This is

even more the case in pension plans with compulsory affiliation. Also, the additional administration costs, which such a procedure can cause (and which in most cases would have to be paid by the beneficiaries), must be limited to an acceptable level. It also has to be mentioned, that a member's risk tolerance may change during his/her lifetime, e.g. it may reduce if a person marries and gets children compared to the time when this person still was living on his/her own. Hence, the assessment of a member's individual risk tolerance is not a one-time event - it would have to be updated regularly. If the risk appetite is only determined for a certain cohort, the investment risks which are accepted by the IORP may not be fitting with the specific risk tolerance of an individual and may hence result in an overall risk position, which this specific individual may not be willing or able to take. The sponsor can take this into account when designing his DC pension plan (including elements such as return smoothing, solidarity between members, investment guarantees, etc.). Hence, a DC risk assessment from a member's point of view starts already with the design of the pension plan and is performed by the plan sponsor at that point in time. It is at that stage independent from the funding vehicle (IORPs, insurers, support funds, institutions operating social security schemes, ...). In this context a certain priority should be given to an adequate but also proportionate level of accuracy in member profiling that feeds into the design of the respective DC strategy.

Q12: Do you agree that the design and the periodical review of the investment strategy, or investment strategies in case of multiple investment options, should consider the long-term risk assessment using projections of future retirement income, taking into account their risk tolerance? Please explain and provide any suggestions.

Yes.

Since market conditions and markets risks change over time – as well as other factors like e.g. life expectancy (which of course is relevant for the member regarding his/her planning for the retirement period) – EIOPA is right in proposing, that such risk assessment and as a consequence a potential adjustment of the investment strategy resulting out of this risk assessment should be done on a regular basis. If risk parameters change, also different investment strategies than the ones currently used may become more “optimal” for reaching the targeted pension level for the respective beneficiaries. So, (similar to a classical ALM-procedure in case of a DB scheme) also the investment strategies would have to be adjusted in such a case. From that, it is more than justified, that EIOPA proposes to make it transparent in the statement of investment principles (SIPP), how the investment strategy is derived and determined on the basis of such risk assessment.

Q13: What should in your view be the frequency of conducting the risk assessment using pension projections? Is at least every three years sufficient, unless there is a significant change in the risk profile, as provided by Article 28 (ORA) and Article 30 (SIPP) of the IORP II Directive. Or should DC IORPs conduct these projections more regularly, as suggested by Article 25 (Risk-management system). Please explain.

At least every three years, unless there is a significant shift in the risk profile.

Every three years is a timeframe, which ensures on one side, that the risk situation of the scheme is regularly assessed (including potential readjustments of the investment strategy) and that at the same time, the effort, burden and costs for the IORP, its sponsors and its beneficiaries resulting out of the assessment stay on an adequate and - most probably - acceptable level. Moreover, an IORP would lose its strategic mindset and would also incur unnecessary costs and effort, if it adjusted its investment strategy (we are not talking about smaller tactical adjustments here) every year. However, in case of very significant structural changes in capital markets or in the risk profile, such assessment would have to be done earlier. But this corresponds exactly to the proposal beneath the first tickbox.

Q14: Do the expectations put forward in the draft Opinion achieve a proportionate approach to DC risk management, fitting small-, medium- and large-sized IORPs? If not, please provide your suggestions to improve proportionality of the draft Opinion.

No.

Not entirely. For more details please refer to the answer of question 9.

Q15: Do you have any other comments on the draft Opinion? If yes, please provide these other comments.

Since the risk assessment should be done from a participant's point of view, all costs, which lower the resulting benefits for beneficiaries have to be taken into account also in the context of a DC risk assessment. Since in a risk assessment risks related to the potential level of benefits (e.g. investment risks) have a different nature than risks related to costs, any offsetting of costs against income positions should be avoided. For the same reason the OPSG supports EIOPA's point of view, that in this context a strict Look-Through-Approach including all costs and charges incurred at the level of investment funds and their managers should be followed. In this context also costs for investment management, which are not fixed, but depend on the performance of the investment manager (e.g. performance fees) should be properly included, if the influence of these costs on the overall result is not insignificant (otherwise these could be left out for reasons of proportionality, since the integration of such costs into the risk model can be quite cumbersome).

Since the assessment should cover the beneficiaries' point of view, any (administrative) costs which are directly paid by sponsoring companies should consequently be left out, because they do not at all influence the future pension result of the beneficiaries. Including such costs would also often not contribute to a higher degree of comparability and would often tell us nothing about the IORP's efficiency and/or the affordability of the IORP for sponsors. First, if an IORP has a sponsor company, to which a big part of its pension products can be assigned, and beside that only few sponsor companies having a relatively small share on the IORP's pension products, it is sometimes the case, that this "majority" sponsor companies pays certain costs. So, in such a case, strictly speaking, the cost level for different sponsor companies might be different. Often sponsor companies have also certain information requirements with regard to an IORP – and are willing to pay for that. In such a situation the cost level is influenced by these sponsor companies themselves and it would be misleading to compare the cost structure (including such costs paid by the sponsors) of that IORP with the cost structure of another IORP having sponsors with much less information requirements resulting in lower administrative costs. Also the argument, that reporting of these cost blocks may give additional insight with regard to the question, if – especially in the situation of a crisis – a sponsor company can still afford the pensions provided by this IORP, has to be questioned, because experience tells, that the size of such administrative costs is usually quite irrelevant for the respective employer.

Since costs are not constant over time, an increase of those costs, which are borne by the beneficiaries is also a risk from their point of view. Hence such costs should also be stressed in a DC risk assessment. In case of a deterministic model realistic cost stress parameters could be developed from analysing e.g. corresponding wage cost indices (which are often published by national statistic bureaus) or consumer price indices. Here, it has to be decided in every single case, which publicly available cost index might be a good proxy for the development of these cost positions of the respective DC scheme. In case of a stochastic model one could look for a suitable probability distribution of the changes of such cost indices and use these changes as a stochastic variable in the model. Of course, correlation and dependencies to other stochastic variables in the model (one would e.g. expect a positive correlation between inflation and nominal fixed income yields) have to be taken into account properly. Having said that, the complexity of any modelling has to be proportionate to its needed accuracy because this additional modelling could imply additional costs for plan members.