Solvency II:
Implications for IORPs

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Implications of Quantitative Requirements of Solvency II

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- Application of Solvency II to IORPs, which is **designed for insurance companies**, results in dramatically increasing solvency capital requirements
- **Assessment of quantitative requirements:**
  - Study „Evaluating the Impact of Risk Based Funding Requirements on Pension Funds" of Allianz Global Investors & OECD:
    - Pension funds (DB plans) which are solvent under IAS standards (100% funding level) would only be about **64%** funded under Solvency II
    - To meet Solvency II requirements, funding level has to be increased to **165%** of current pension provisions
    - German Pensionskassen: EUR 100 billion vested rights of German occupational pensions ➔ **36 Mrd. € underfunding**
    - *„final nail in the coffin for DB schemes"*

Implications of Quantitative Requirements of Solvency II

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- **Our simulation results (QIS 4) fully support the findings of the study of Allianz Global Investors & OECD**
- **Main reasons for dramatically increasing solvency capital requirements:**
  - High impact on German Pensionskassen because of **liabilities' long duration** due to their **long-term promises** (i.e., pensions instead of capital payments and marginal lapse rates)
  - **A more homogeneous product**: longevity risk is not hedged by mortality risk
  - Numerous **differences** between IORPs and insurance companies **are not adequately considered** (e.g., subsidiary employer liability, „remediation clause")
  - **Market valuation** contradicts the **long term investment strategy** of IORPs (e.g., „buy and hold" strategy)

Historical Development of Solvency Rules for German Pensionskassen

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Initial no solvency requirements for IORPs

Solvency I:
1% of actuarial reserve & future surplus returns as (implicit) solvency capital

× 5

Solvency I

(New life assurance directive from 2002):
future surplus returns can no longer be allowed – ca. 4,8% of actuarial reserve

× further multiple increase

Solvency II:
New approach

1996 2007 2012

Adequate regulatory framework for IORPs

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- We recognize the need to strengthen risk management processes of IORPs ➔ Focus exclusively **on qualitative aspects** (Pillar II)
- The review process of current solvency requirements for IORPs has to be **reconsidered**
- There is no need to amend the current solvency requirements (Solvency I) as these have proved to be successful as of yet
- **Socio-political implication** of higher solvency capital requirements have be explicitly taken into account
- Current solvency requirements (Solvency I) should be maintained