31 July 2012

Joint Property Industry Response to EIOPA consultation on the IORP QIS

General comments

The undersigned represent a wide array of organisations in the real estate sector. Together, our members range from IORPs and other institutional investors, including insurance companies, to fund /asset managers, property companies and property professionals operating in the real estate sector.

We support the overall objectives of recent legislative initiatives to stabilise the financial markets and lower systemic risk, including the objectives of the White Paper - An Agenda for Adequate, Safe and Sustainable Pensions[1]. However, we would like to express our concerns with EIOPA's proposal to apply significant features of the Solvency II (SII) framework to the IORP Directive. Our concerns come from both a macro-economic as well as technical perspective and can be summarised as follows:

1. IORPs differ significantly to insurance companies – it is not appropriate to transpose SII rules onto IORPs;
2. The IORP QIS imports from SII several flaws and areas of uncertainty, including ones which have been corrected in SII. There are also several outstanding technical problems relating to SII's treatment of real estate that need to be resolved before they are applied to IORPs;
3. Imposing SII-type rules on IORPs will reduce the adequacy of pension provision by side-lining capital available for investment. Pension fund performance and returns will suffer as a result;
4. The 25% property SCR under SII is based on flawed data. Pan-European data sources indicate that a 15% capital charge for property is more appropriate; and
5. Reduced institutional investment into the built environment (resulting from disincentives, uncertainty and arbitrage under the SCR) will have severe negative macroeconomic effects.

Direct and indirect investment in the many forms of physical real estate (both commercial and residential property) is playing an ever more prominent role in the portfolios of IORPs, who recognise the natural 'marriage' between the needs of European retirees and the long-duration, contractual and inflation protected cash flows provided by property, as well as the diversification benefits. We fully support the Europe 2020 strategy of encouraging greater long-term investment in the European economy, but believe that the IORP proposals outlined in QIS 5 risk having the opposite effect.

[1] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0055:FIN:EN:PDF

1. IORPs differ from insurance companies and SII should not be transposed onto IORPs

IORPs have a different general business model and liability profile to those of insurance companies, which has been well articulated by the IORP industry members responding to this consultation[2], but it is important to note the following high-level points.

IORPs do not provide consumer products (like insurance products), but arrangements agreed by employers and employees in the context of an occupational relationship. In general, IORPs are not-for-profit organisations, so all fund surpluses accrue to the benefit of participants: workers and retirees. A related consequence of not-for-profit status is that IORPs are not focused on pursuing profit, and due to the very stable and predictable payment obligations and the long-term nature of these obligations, IORPs are able to maintain a countercyclical investment policy and a prudent long-term investment horizon.

The capital requirements for IORPs taken from the SII Directive aim to provide a high level of pension security in the short term. Under SII, institutions must be able to demonstrate that the probability that the level of technical provisions will exceed the total level of assets will be lower than 0.5% on a one-year horizon – which regulators have determined makes sense given the business models of insurance companies.

However, if this kind of regulation focused on short-term liquidity is applied to IORPs, IORPs will be forced to maintain high capital buffers and the required level of assets will increase. This will lead to lower pension benefits and/or higher pension contributions across Europe. IORPs could naturally shift to an investment mix that consists of less risk-bearing capital, but while such a strategy results in a lower capital buffer in the short run it also leads to lower expected returns and so lower pensions in the long run[3].

Furthermore, SII's requirement for a very high level of short-term security is not consistent with IORPs' business model. IORPs' long-term investment horizon means that any short-term deficits arising from financial turmoil can be recouped in the long run as a result of the long duration of IORP liabilities, IORPs' ability to share risks among generations and through the use of additional risk-mitigating instruments. If SII's short-term perspective is applied to IORPs, it will disturb the current balance that IORPs provide between long-term pension security levels, adequate pension incomes and affordability.

Despite these differences and the widespread acknowledgement of this throughout the industry, a large part of the QIS consultation document seems to have been transposed from the SII's QIS 5. This is disappointing, as on numerous occasions the European Commission has acknowledged the fundamental differences between insurers and IORPs and has asserted that the IORP revision would not be an exercise in direct transposition[4].

[2] For example, see the response of the European Federation for Retirement Provision. www.efrp.org/

[3] WinterFrost, N, Page, D., *White Paper: Vision 2020* (2012) The Society of Pension Consultants.

[4] See, e.g., Speech of Michel Barnier, Member of the European Commission responsible for Internal Markets and Services, *Insurance reforms: putting the European economy back on the path towards sustainable growth*, at Insurance Europe Conference, Amsterdam, 1 June 2012.

2. There are a number of outstanding technical problems with SII's treatment of real estate investment

Several flaws and inconsistencies that were contained in the SII QIS 5 have been incorporated in the IORP QIS, even though these flaws have already been corrected in the Commission's most recent SII draft Directive. For example, the provision that any financing in a real estate investment results in it being treated under the equity module appeared in the SII QIS 5, but has been corrected in the Commission's current draft of the SII Directive. Nevertheless, this provision is included in the IORP QIS. This oversight results in uncertainty in determining the SCR category to which leveraged real estate assets belong under IORP, and raises the risk of regulatory mismatch and arbitrage. Differences between the regulation of SII and IORPs should be thoroughly considered.

In addition, flaws that still remain in the current SII draft Directive are incorporated into the IORP QIS, even though they could easily have been avoided. For example, the importance of inflation risk is underestimated in both initiatives and the 25% standard solvency capital charge for property is adopted without any real discussion in the IORP QIS despite credible research which concludes that the standard charge should be no greater than 15%[5].

The issues identified above are particularly relevant for investment into real estate as there are many different forms of direct and indirect exposure to the sector arising from the capital intensive nature of the asset and the importance of financing in the underlying business. Accordingly, there remain significant uncertainties in the application of SII to the real estate sector, with no process in place to resolve them. This includes the treatment of various forms of real estate vehicles (property companies, REITs and collective investment vehicles/funds) and the treatment of property debt (see below).

A further unresolved issue with SII is the way in which it treats lending to commercial real estate, which takes no account of the value of collateral. The latest draft of the SII implementing guidelines requires that such lending be included in the general provisions for corporate bonds under the spread risk module. The starting point under this provision is a credit rating by a nominated credit rating agency, which does not reflect normal practice in property lending as individual commercial real estate mortgage loans are not rated in this way. In the absence of any clear provision that would allow collateral to be taken into account, the assumption would seem to be that it should be ignored. If the proposed treatment of commercial real estate loans is not rectified it appears that there will be no distinction for SII purposes between an unrated real estate loan secured by a mortgage over a commercial property and an unrated unsecured loan. This is an illogical and inappropriate approach to commercial real estate lending and, if replicated under the IORP framework, will have further damaging impacts on investment into real estate and the performance of pension funds, creating artificial regulatory incentives to make investment decisions that do not properly take risks into account.

Pension fund investment into real estate is on a much larger scale than insurance companies[6] and involves many more individual funds. According to the CfA there are 140,000 IORPs of which many

[5] *The IPD Solvency II Review, Informing a new regulatory framework for real estate*, 15 April 2011, updated 21 July 2011.
[6] *INREV / ANREV Fund Managers Survey* (2012).

have a handful of members[7], as opposed to 4,753 insurance undertakings[8]. The flaws and uncertainties in SII would be significantly amplified if they are transposed onto the pension fund sector. In our view, it therefore seems unwise to transpose the SII framework onto IORPs without first properly understanding its impact and clarifying the significant uncertainties that exist in its application.

The holistic balance sheet approach and the SCR requirements will no doubt allow some flexibility for the larger institutional investors to develop internal models that reflect the specific risk characteristics of their property exposures and mitigate some of the concerns above. However, this approach and flexibility will not be available for the thousands of smaller pension funds who will thus be placed at a disadvantage to the larger players.

3. Effect of regulatory changes on adequacy of pension provision

The proposed risk-based capital requirements and valuation against the risk-free interest rate are inherently volatile and pro-cyclical, and will endanger the stability, performance and long-term sustainability of IORPs. SII is based on the capital adequacy framework for the banking industry, which has a very different business model to insurance, and now that these same principles are proposed to be applied to IORPs, there is a real danger that the convergence of behaviour-influencing regulation will increase the risk to the financial system and the wider economy.

As noted above, IORPs have very stable and predictable payment obligations, and therefore long-term and stable investment strategies that focus on securing long-term, predictable cash-flows as opposed to short-term returns. They also do not rely to the same extent as other investors on short-term liquidity. Real estate is an ideal asset class for many IORPs to diversify their portfolios and match their liability schemes, as it provides stable cash flows, relatively low volatility[9], low correlation with other asset classes, and positive inflation-adjusted returns over the long term[10].

Any regulation that creates disincentives for IORPs to invest in property by applying excessive solvency capital requirements will inevitably lead to them having to adopt less appropriate investment strategies that do not fully match their risk profiles and liability schemes.

Reducing risk and promoting financial stability without undermining economic recovery and growth is a challenging task. Proportionate and appropriate regulatory responses that carefully analyse where risk lies and formulate a tailored response are therefore essential. In this context we question whether applying the SII regime to IORPs is the right approach.

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[7] Paragraph 1.2 of the Call for Advice.

[8] Figure for end-2009. See page 21 of EIOPA's Report on the fifth Quantitative Impact Study (QIS5) for Solvency II. https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/QIS5_Report_Final.pdf

[9] See, e.g., Karlekar, I., *Commercial Real Estate: An 'Alternative' Goes Mainstream*, Investment Advisor, 22 May 2012.

[10] Lizieri, C., Alcock, J., Satchell, S., Steiner, E., & Wongwachara, W. (2012), *Real Estate's Role in the Mixed Asset Portfolio: A Re-examination*, Investment Property Forum, and Blake, N., Goodwin, A., McIntosh, A., & Simmons, C. (2011), *Property and Inflation*, Investment Property Forum.

4. SII's property SCR is based on flawed data – a 15% capital charge for property is more appropriate

If, notwithstanding our comments above, EIOPA is determined to proceed with applying the SCR approach used in Solvency II to IORPs, it must take into account research which clearly demonstrates that the proposed 25% solvency capital charge for real estate does not represent the true volatility of property markets in Europe. A review of Solvency II[11] by independent research organisation IPD using data representative of European property market volatility clearly demonstrates that it would be unreasonable to impose a capital solvency charge of more than 15%. We hope that as a result of the QIS consultation process, EIOPA will conclude that the 25% solvency capital charge for real estate is not appropriate and that an SCR of not more than 15% more accurately reflects property volatility across Europe. We strongly urge EIOPA and the European Commission to revise the solvency capital charge for real estate. A new SCR for real estate that uses all the data available and is more representative of all European property markets should be developed. The IPD review would be an excellent starting point for such an exercise, although other data sources are available and these should be explored.

INREV is currently collecting information on the range of data sources available to measure real estate volatility across European Member States by market and sector that will include details on the frequency, length of time series and modelling assumptions used. This project should be completed in several months and will provide policymakers with a mapping of data sources that should be extremely useful for calculating a solvency capital charge for real estate that more accurately reflects the property volatility than the currently proposed 25%. We would be happy to meet with EIOPA and Commission officials to explain this project in more detail and explore how it might be used to support a more representative solvency capital charge for real estate volatility in Europe.

5. Negative impact on European macro economy

Real estate is the backbone of businesses and society. The commercial property sector is the key provider of offices, shops and other retail facilities, factories and warehouses, housing and other forms of real property that are an essential part of the infrastructure for a well-functioning European economy. The commercial property sector delivers and manages the infrastructure needed for entrepreneurship to thrive, and is also a fundamental source of employment, economic growth and technological advance.

The commercial property sector directly contributed €285 billion to the European economy in 2011, which is about 2.5% of the total economy, and it directly employs over four million people[12]. Investments in commercial real estate also provide critically important long-term and relatively stable returns for institutional investors. Regulation that creates incentives to lower investments in real property through high solvency capital charges will therefore have three major undesirable effects:

- it will lower risk-adjusted returns to IORPs, making it more difficult for them to meet their payment obligations;

[11] *The IPD Solvency II Review, Informing a new regulatory framework for real estate*, 15 April 2011, updated 21 July 2011.

[12] Real Estate in the Real Economy: Supporting growth, jobs and sustainability (2012) EPRA/INREV.

- it will result in the reduced creation of new jobs and lower GDP stimulation at a time when European economies need to support growth and jobs; and
- it will result in an underperforming European real estate sector, less able to meet the infrastructure and accommodation needs of a growing population and respond to the challenges of reducing energy consumption in line with the EU 2020 Energy Efficiency targets[13].

Currently €715 billion of investments in real estate are provided by IORPs and insurers[14]. Considering that IORPs are among the largest investors in real estate, it can be expected that a high solvency capital requirement will sharply reduce this amount, just as some European insurers report that high solvency capital requirements under SII are already causing them to reduce their real estate investments[15], with a resulting reduction in economic growth and jobs.

Reducing volatility in financial markets will create a favourable investment climate from which the real estate sector will benefit as a whole. Real estate is a highly capital intensive industry, which relies more than many other sectors on readily available financing opportunities. However, the right balance needs to be struck in regulatory terms between creating stable and transparent markets, and not undermining the ability of the real estate sector to continue to foster economic growth and employment in Europe. Achieving this balance is critical if real estate is to support the Europe 2020 strategy of achieving greater long-term investment in the European economy.

The proposed high solvency capital requirements for investments in risk-bearing capital creates a strong incentive for IORPs to invest in so-called risk-free bonds instead of physical assets and businesses such as property funds and property companies. IORPs are important suppliers of capital to many kinds of 'real economy' businesses, not only the property sector, and an SCR regime for IORPs could restrict their investment opportunities. That would not only result in expected lower returns but also in expected lower pension benefits (or higher contributions). This outcome would also have a negative impact on growth and employment in the European Union and will not lead to greater long-term investment in the European economy.

We are concerned that other regulations such as CRD IV, SII, and possibly Shadow Banking, will reduce available capital during times when it is most needed. While we support the general principles of these regulations, EU regulators should proceed carefully when developing regulations that will further reduce the ability of major investors to finance the real economy. A regulatory change that makes this less likely undermines other strong political objectives. As stated above, this is particularly relevant to the question of transposing of SII principles to IORPs without first understanding the impact of the SCR on capital flows into the built environment.

The impact of distorting incentives to invest in property by imposing excessive solvency capital requirements on IORPs will have important implications for the European economy at a time when cash strapped Governments are looking to institutional investors from the private sector to buy

[13] http://ec.europa.eu/energy/efficiency/consultations/doc/2012_05_18_eeb/2012_eeb_consultation_paper.pdf
[14] Real Estate in the Real Economy: Supporting growth, jobs and sustainability (2012) EPRA/INREV.
[15] http://ipe.com/realestate/solvency-ii-will-force-insurance-companies-to-slash-real-estate_42430.php

property from the state, pay for infrastructure and new housing, and meet/finance the retrofitting needs of the European built environment. This is further exacerbated when taking into account the cumulative effect of recent financial market regulations.

Closing comments

We welcome the opportunity to comment on the IORP QIS. We would be happy to meet with EIOPA to explain any of the comments or suggestions contained in this submission in more detail and to explore ways in which we can constructively contribute to the development of a balanced and effective IORP Directive. We would also very much appreciate an opportunity to share with EIOPA details of the data mapping project.

Organisation	Description
EPRA	EPRA is the voice of the European publicly traded real estate sector and represents publicly listed property companies, (including REITs), the investment institutions who invest in the sector and the firms and individuals who advise and service those businesses. The institutional investors that EPRA represent include the largest pension funds in Europe with a long track record of investment into the real estate sector. Between them our 200 members represent over €250bn of real estate investments.
INREV	INREV is the European Association for Investors in Non-listed Real Estate Vehicles. Since its launch in 2003, it has grown to almost 350 members from more than 28 different countries. INREV's aim is to improve the accessibility of non-listed real estate funds for institutional investors by promoting greater transparency, professionalism and standards of best practice. INREV is led by institutional investors and supported by other market participants such as fund managers, investment banks, academics, lawyers and other advisors. As a pan-European body, INREV represents a unique platform for sharing knowledge on the non-listed real estate funds market.
BPF BRITISH PROPERTY FEDERATION	The British Property Federation is devoted to representing the interests of all those involved in property ownership and investment. We aim to create the conditions in which the property industry can grow and thrive, for the benefit of our members and of the economy as a whole. Because our membership includes the biggest companies in the property industry - property developers and owners, institutions, fund managers, investment banks and professional organisations that support the industry - we are able to provide the knowledge and expertise needed by legislators (UK and EU) and regulators (including various financial, planning and environmental bodies) in taking their decisions.
ZIA	The German Property Federation ZIA is a membership organisation founded in order to represent the interests of the whole real estate industry. We pursue the objective to create an environment in which real estate investments can prosper. Therefore ZIA advocates the interests of the German real estate industry vis-à-vis the political decision makers in Germany and in the EU. Our more than 140 members – including the biggest companies in the property industry - represent the industry at any stage of the supply chain. Our membership also includes a various number of property linked associations. ZIA was founded in 2006 and is a member of the Federation of German Industries (Bundesverband der Deutschen Industrie).
IPF Investment Property Forum	The Investment Property Forum (IPF) is the leading UK property investment organisation for individual members. It comprises an influential network of approximately 2,000 senior professionals, including investment agents, fund managers, bankers, lawyers, researchers, academics, actuaries and other related professionals, all active in the property investment market. The IPF's objective is to enhance the understanding and efficiency of property as an investment, including public, private, debt, equity and synthetic exposure, for its members and other interested parties, including government by undertaking research and special projects and ensuring effective communication of this work.
FASTIGHETSÄGARNA	The Swedish Property Federation is a highly pro-active trade organization promoting an efficient real estate market in Sweden. Almost 20,000 property owners are members, organized in one of Sweden's 5 regional property associations. Our members represent the entire spectrum of the property industry, owning or managing premises and rental apartment buildings, industrial properties and tenant-owners' associations.

AREF	The Association of Real Estate Funds represents the UK unlisted real estate funds industry and has more than 80 member funds with a collective net asset value of over €52billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Pooled Property Funds Indices and the AREF/IPD Property Fund Vision Handbook.
RICS the mark of property professionalism worldwide	RICS is the world's leading qualification when it comes to professional standards in land, property and construction. In a world where more and more people, governments, banks and commercial organisations demand greater certainty of professional standards and ethics, attaining RICS status is the recognised mark of property professionalism. Over 100,000 property professionals working in the major established and emerging economies of the world have already recognised the importance of securing RICS status by becoming members. RICS is an independent professional body, committed to setting and upholding the highest standards of excellence and integrity – providing impartial, authoritative advice on key issues affecting business and society.

Q17. Do stakeholders believe that the risks IORPs are facing are adequately reflected in the calculation of the SCR and MCR (Chapter 3 and 4)? Are there in the stakeholders' view any risks being considered that are not material and could be excluded from the technical specifications? Are there other risks that should be considered in the calculation of the SCR?

We do not believe that the risks IORPs are facing are adequately reflected in the calculation of the standard SCR market risk module. As discussed in more detail in our general comments above, applying to IORPs a framework that was designed for insurers (and based on banking regulation) is not suitable given that IORPs have a different business model and pay-out obligations. The obligations of IORPs are stable and predictable and therefore do not require large amounts of short-term available capital. Long-term investments like real estate provide the long-term, predictable and relatively stable cash flows that IORPs rely on to match their liabilities.

For IORPs, rental income generation from real estate investments tends to be more important than short-term returns and rental income flows are managed in even volatile markets by long-term leases with stable tenants and diversified lease expiries. Rather than liquidating assets for liquidity needs, IORPs tend to hold on to assets during market downturns, as was shown in the recent financial crisis.

We also believe that inflation risk is underestimated in the IORP proposals. Inflation risk could be considered in the calculation of the SCR, especially for unconditional inflation linked pension benefits and final salary plans. In addition, the notion (also a feature of SII) that no capital requirement should apply to borrowings by (or guaranteed by) national government of an EEA state cannot be logically supported in light of the sovereign debt crisis that has been playing out for the last two years.

SCR.5.55. sets the property solvency capital charge at 25%, which we believe does not adequately reflect the risks IORPs are facing. The property solvency capital charge has been carried over from the currently proposed SII regime for insurers, and research demonstrates that this figure is not an appropriate reflection of the true risk posed by European property investments. Applying the same figure to IORPs raises the same arguments, as well as additional concerns specific to IORPs detailed in our general comments, such as the fact that they are not focused on pursuing profit and, due to the very stable and predictable payment obligations and the long-term nature of these obligations, they are able to maintain a countercyclical investment policy and a prudent long-term investment horizon. In turn, IORPs' long-term investment horizon means that any short-term deficits arising from financial turmoil can be recouped in the long run as a result of the long duration of their liabilities, their ability to share risks among generations and through their use of additional risk-mitigating instruments.

The 25% solvency capital charge does not reflect the entire spectrum of the European property market and ignores diversification benefits. It is therefore wrong to continue to rely on the figure proposed for insurers under SII and extend its application to IORPs. Alternative data sources exist and their validity has been well documented in an industry study conducted by IPD which clearly establishes that an SCR that is truly reflective of European property market volatility should be no greater than 15%. As insurers across Europe develop internal models for real estate in response to

Solvency II, their data clearly support the conclusion that there is significantly lower volatility in European real estate markets than the QIS proposes. National regulators will be aware of this fact from their preliminary discussions with insurance companies that are developing internal models under Solvency II.

As stated in the QIS section HBS.3.14 c) it is difficult to derive property implied volatility in the absence of a property derivatives market, and we agree that the volatility of a property index may be used to calibrate market solvency capital charges. However, the index must be representative of the entire European market. The data used to compute the 25% solvency capital charge cannot be reasonably justified to support the calibration of a representative, EU-wide property risk sub-module as it is based on data from a single country. Such an approach to risk calibration does therefore not accurately reflect the risk posed by real estate investments.

As noted in our general comments above, a property risk sub-module that overstates the real risk results in side-lining of capital needed to produce stable returns for IORPs and to support real estate-related employment and economic growth. Furthermore, it is market distortive as it reduces incentives to invest in a relatively stable asset class with strong portfolio diversification characteristics.

Therefore we urge EIOPA to reassess the data used to determine the Value at Risk for property and carry out a new study for setting the standard capital requirement for property that is transparently calculated and based on more representative data series from a broader selection of the EU property investment markets.

Furthermore, EIOPA suggests in SCR.5.4. that the correlation of property to equity is 0.75. We note that property scores computed using IPD data never exceeded a 0.50 correlation for equities, and were more commonly negatively related to interest rates. The IPD study supports this notion. We would therefore welcome further discussion with EIOPA to understand how the correlation has been calculated and what methodology and data have been used.

Finally, IPD research suggests that a reduction from 99.5% to either 97.5% or 95% in the confidence level used in the SCR calculation would have a very limited effect on 12 month Value at Risk for the European property markets reviewed as part of the study. Only when the confidence level is reduced by 5-10 percentage points is there a noticeable difference. Accordingly, simply reducing the confidence level required by the IORPs proposal should not be seen as an alternative to setting an appropriate SCR for property, which truly reflects European property market volatility.

Q20. Do stakeholders believe that the simplifications provided for the calculation of the SCR (for spread risk on bonds in section 3.5, value of collateral in section 3.6 and mortality, longevity, benefit option and catastrophe risk in section 3.7) are adequate? Do stakeholders have any concrete suggestions for additional simplifications?

For the reasons stated in our general comments and our answer to Question 17, which we repeat below, we do not believe that the simplification provided for the calculation of the SCR for real estate in SCR 5.55 is adequate.

To begin, we do not believe that the risks IORPs are facing are adequately reflected in the calculation of the standard SCR market risk module. As discussed in more detail in our general comments above, applying to IORPs a framework that was designed for insurers (and based on banking regulation) is not suitable given that IORPs have a different business model and pay-out obligations. The obligations of IORPs are stable and predictable and therefore do not require large amounts of short-term available capital. Long-term investments like real estate provide the long-term, predictable and relatively stable cash flows that IORPs rely on to match their liabilities.

For IORPs, rental income generation from real estate investments tends to be more important than short-term returns and rental income flows are managed in even volatile markets by long-term leases with stable tenants and diversified lease expiries. Rather than liquidating assets for liquidity needs, IORPs tend to hold on to assets during market downturns, as was shown in the recent financial crisis.

We also believe that inflation risk is underestimated in the IORP proposals. Inflation risk could be considered in the calculation of the SCR, especially for unconditional inflation linked pension benefits and final salary plans. In addition, the notion (also a feature of SII) that no capital requirement should apply to borrowings by (or guaranteed by) national government of an EEA state cannot be logically supported in light of the sovereign debt crisis that has been playing out for the last two years.

SCR.5.55. sets the property solvency capital charge at 25%, which we believe does not adequately reflect the risks IORPs are facing. The property solvency capital charge has been carried over from the currently proposed SII regime for insurers, and research demonstrates that this figure is not an appropriate reflection of the true risk posed by European property investments. Applying the same figure to IORPs raises the same arguments, as well as additional concerns specific to IORPs detailed in our general comments, such as the fact that they are not focused on pursuing profit and, due to the very stable and predictable payment obligations and the long-term nature of these obligations, they are able to maintain a countercyclical investment policy and a prudent long-term investment horizon. In turn, IORPs' long-term investment horizon means that any short-term deficits arising from financial turmoil can be recouped in the long run as a result of the long duration of their liabilities, their ability to share risks among generations and through their use of additional risk-mitigating instruments.

The 25% solvency capital charge does not reflect the entire spectrum of the European property market and ignores diversification benefits. It is therefore wrong to continue to rely on the figure proposed for insurers under SII and extend its application to IORPs. Alternative data sources exist and their validity has been well documented in an industry study conducted by IPD which clearly establishes that an SCR that is truly reflective of European property market volatility should be no greater than 15%. As insurers across Europe develop internal models for real estate in response to Solvency II, their data clearly support the conclusion that there is significantly lower volatility in European real estate markets than the QIS proposes. National regulators will be aware of this fact from their preliminary discussions with insurance companies that are developing internal models under Solvency II.

As stated in the QIS section HBS.3.14 c) it is difficult to derive property implied volatility in the absence of a property derivatives market, and we agree that the volatility of a property index may be used to calibrate market solvency capital charges. However, the index must be representative of the entire European market. The data used to compute the 25% solvency capital charge cannot be reasonably justified to support the calibration of a representative, EU-wide property risk sub-module as it is based on data from a single country. Such an approach to risk calibration does therefore not accurately reflect the risk posed by real estate investments.

As noted in our general comments above, a property risk sub-module that overstates the real risk results in side-lining of capital needed to produce stable returns for IORPs and to support real estate-related employment and economic growth. Furthermore, it is market distortive as it reduces incentives to invest in a relatively stable asset class with strong portfolio diversification characteristics.

Therefore we urge EIOPA to reassess the data used to determine the Value at Risk for property and carry out a new study for setting the standard capital requirement for property that is transparently calculated and based on more representative data series from a broader selection of the EU property investment markets.

Furthermore, EIOPA suggests in SCR.5.4. that the correlation of property to equity is 0.75. We note that property scores computed using IPD data never exceeded a 0.50 correlation for equities, and were more commonly negatively related to interest rates. The IPD study supports this notion. We would therefore welcome further discussion with EIOPA to understand how the correlation has been calculated and what methodology and data have been used.

Finally, IPD research suggests that a reduction from 99.5% to either 97.5% or 95% in the confidence level used in the SCR calculation would have a very limited effect on 12 month Value at Risk for the European property markets reviewed as part of the study. Only when the confidence level is reduced by 5-10 percentage points is there a noticeable difference. Accordingly, simply reducing the confidence level required by the IORPs proposal should not be seen as an alternative to setting an appropriate SCR for property, which truly reflects European property market volatility.