Comments Template on Consultation Paper on Further Work on Solvency of IORPs		Deadline 13 January 2015 23:59 CET
Name of Company:	European Private Equity & Venture Capital Association (EVCA) on behalf of the Public Affairs Executive (PAE)	
Disclosure of comments:	Please indicate if your comments should be treated as confidential:	Public
	Please follow the following instructions for filling in the template: ⇨ Do **not** change the numbering in the column "reference"; if you change numbering, your comment cannot be processed by our IT tool ⇨ Leave the last column empty. ⇨ Please fill in your comment/response in the relevant row. If you have no response to a question, keep the row empty. ⇨ Our IT tool does not allow processing of comments/responses which do not refer to the specific numbers below. **Please send the completed template, in Word Format, to CP-14-040@eiopa.europa.eu . Our IT tool does not allow processing of any other formats.** The numbering of the questions refers to **Consultation Paper on Further Work on Solvency of IORPs**.	
Reference	**Comment**	
General Comment	• The European private equity industry welcomes the opportunity to comment on EIOPA's Consultation Paper on Further Work on Solvency of IORPs. We will focus our comments on the areas of key relevance to the private equity industry. • Pension funds invest in the private equity asset class as the characteristics of such investments correspond well with their long-term investment horizon and meet their interest to invest in an asset class of substantially different characteristics compared to listed equities and bonds. Private equity funds, which operate over at least a ten	

year period, have for many years been trusted by many of Europe's largest providers of current and future pensioners' income as a source of stable, strong, risk adjusted returns. This explains why, in the period from 2007 - 2013, pension funds accounted for over 27% of all funds raised by the European private equity industry (35% in 2013).

- Due to the very positive risk-/return characteristics and the long-term investment horizon of private equity funds, many pension funds currently hold large allocations to private equity. In some cases the allocation even reaches a quarter of the total assets of the pension schemes which is a big difference to the allocation of a typical insurance company.

- Private equity not only delivers strong returns to pension funds - critical for defined benefit funds to be able to meet their pension liabilities as they fall due and to defined contribution funds to generate the wealth required to provide the member's future retirement income – but also provides the long-term investment needed to deliver growth in the real economy. It is this long-term growth, sustained by long-term capital, which provides a foundation for job creation, investment and tax revenues. Over the past four years, European pension funds have invested €73bn, via private equity, in European companies. More than 87% of private equity backed companies are small to medium sized enterprises ("SMEs"), which constitute the backbone of the European economy.

- Private equity is an asset class which adds value to a pension fund portfolio through a high degree of diversification. The typical investment form of a pension fund is through private equity funds. As a private equity fund typically invests in a number of portfolio companies over a three to five year investment period, the pension fund is able to build up a highly diversified portfolio of privately held companies. These companies operate in different industries, countries or even continents and are in different life cycles of their business. With only a few private equity fund investments, the average pension fund holds a portfolio of privately held companies, which then have backing they need to grow.

- Private equity is a long-term asset class that focusses on the long-term growth of the companies in which it invests. Hence, it is very different to hedge fund strategies. The lifetime of a private equity fund is also typically around 10 years and as there are no possibilities for early redemption the companies receiving investments are given time to develop their growth strategies over many years.

- The private equity industry recognizes the importance of having a robust regulatory framework to help ensure the security of pension benefits to members. However, we have concerns whether private equity can be included in a feasible and appropriate way in the Holistic Balance Sheet (HBS) approach; especially with a mark-to-market valuation tool. We also feel that the potential application of Solvency II–style requirements to IORPs might be inappropriate and disproportionate. We are concerned that if such rules were implemented they could affect pension funds' investment strategies resulting in a number of negative consequences for pension funds and their members and for private equity and the wider economy.

- Although we understand that within any supervisory framework it is always going to be a challenge to balance the key elements involved (risk and return; assets and liabilities; short-term and long-term) we are convinced that there is a need for such a balance in any framework for the EU pension industry. A simple focus on short-term, downside risk protection may underplay the importance of the broader risk to the economy of inadequate returns being achieved to fund retirement provision, or as a result of capital being misallocated. In this regard we strongly believe that return-seeking assets, such as private equity, have an important role to play in pension provision. Exposure to return-seeking assets is necessary to generate the real returns needed to meet the pension liabilities as they fall due. They also help mitigate the costs of providing pensions as without the ability to generate real returns, the cost of funding pension provisions would be higher for all stakeholders.

- We welcome the acknowledgement by EIOPA (and the Commission) that IORPs are suppliers of long-term capital to the European economy through investments in assets such as private equity. Private equity is an asset which benefits IORPs by being a return seeking asset with low long-term risks and benefits the wider economy by providing long-term capital to the economy and helps build sustainable businesses.

- We think it is important for all IORP stakeholders, and for the wider economy, that a new regulatory framework should not discourage IORPs from making a decision to allocate assets to private equity (or any other asset class traditionally invested in as part of a balanced, prudently-diversified portfolio). While all decisions need to be made in a considered and measured fashion, taking into account the liabilities and circumstances of IORPs, we believe that an IORP should have some flexibility, within the suggested regulatory framework, to determine how to balance the various detailed decisions to be made, with regards to its assets and liabilities.

- It is our firm belief that any framework, which effectively discourage IORPs for making a decision to allocate assets to a particular long-term asset class would not be in the interests of any of the stakeholders involved. In addition to the direct impact on long-term investments and the potential impact on growth in Europe, this would also restrict the investment choices for IORPs, which can result in lower long-term returns

	for their members and less diversification. • We understand the importance of setting a robust supervisory framework within which IORPs can operate. However the private equity industry's key concern is with EIOPA's recommendation that all valuations should be market-consistent. We think that the market-based approach for valuing private equity represents a fundamental misunderstanding of the risk faced by an institutional investor, like pension funds, in this asset class. • When valuing investment, some assets are not tradable assets with a daily market value. It is, therefore, not appropriate to disregard this fact when applying a valuation methodology to such assets. The attempt to do so will produce a number which is without meaning in terms of valuation – the number calculated will bear little or no relation to the actual value of these assets to the investor. Consequently, should such a "value" be incorporated in the HBS, it could well deter IORPs from considering allocating assets to that asset class. Private equity is an asset class for which it is neither logical nor warranted to take a standard mark-to-market approach to valuation. • In order to apply a market-based valuation methodology, it assumes that the asset class has a daily price that can be independently sourced. It further assumes that the market is both liquid and deep (large volumes of transactions can be rapidly executed without major impact on the market price). It is characteristic that transactions are sufficiently frequent to define the market price. • IORPs most generally gain exposure to private equity via a portfolio of unlisted funds. These unlisted funds do not have the characteristics required to apply a market-based	

approach to valuing them. But with a widely-recognized modification it is possible to fit a non-marketable asset class into market-based framework.

- When it is not possible to use a market-based approach a mark-to-model approach is generally adopted, i.e. the valuation is identified by reference to benchmarking and extrapolation. It also requires independent verification of the values used. The private equity industry has set down international guidelines on valuation based on such an approach which have widely been adopted across the industry (and in academic research on the industry) and used for many years.

- Unless a modified approach to determining the “market value” of private equity assets is taken within the HBS framework, then IORPs will be deterred from considering investing in the asset class on behalf of their beneficiaries. We believe this will have a detrimental impact for all stakeholders in the IORP, by reducing the scope to generate real returns to meet liabilities, thus potentially reducing security to beneficiaries and increasing costs.

- In addition, if IORPs reduce their allocation, or cease to allocate assets to private equity it will have a detrimental impact on the provision of long-term capital to European companies, with the subsequent adverse consequences for the health of the European economy. In 2013, private equity industry invested more than EUR 35 billion in approximately 5,000 companies in Europe. More that 87% of all private equity investments are in SMEs and this is investment that yields real benefits for the economy.

- While we recognize that private equity is a smaller part of just one section within the overall HBS, we believe that without a simple, and technically correct adaptation of

	the market-approach to valuation, both IORPs (and all their stakeholders) and the health of the European economy would be disproportionately adversely affected, no matter which of the proposed supervisory frameworks were to be adopted. However, we would also like to highlight that compared to insurance companies, private equity plays a more important role in pension funds' allocation and the allocation of some large and sophisticated global pension funds even reaches up to a quarter of their entire asset allocation. A change in regulation might have a massive impact on their future return-/risk characteristics. • We would welcome the opportunity to engage with EIOPA (and the Commission) and provide further information and analysis on this subject to assist in ensuring the above mentioned adverse consequences are avoided.	
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Q72	• We are concerned that the potential application of the Solvency II – style requirements to IORPS might be inappropriate and disproportionate for a long-term asset class like private equity. • However if it were decided to establish new capital requirements for IORPs the market-consistent approach should not be limited to a pure mark-to-market valuation for all investments as this is not always appropriate, or indeed technically correct. It is necessary to ensure that a reasonable approach to valuing all investment assets is taken within the framework of a market consistent approach. When valuing assets which are not marketable it is normal to modify the approach in order to maintain the integrity of the valuation methodology. Without such a modification the frameworks proposed would have an adverse impact on economic growth and long-term investment, as a result of IORPs reducing the flow of capital for investment in non-listed companies, in particular small- and medium-sized companies. • Private equity is an asset class which adds value to a pension fund portfolio through a high degree of diversification. A pension fund typically invests in a number of private equity funds. As each private equity fund typically invests in a number of portfolio companies over a three to five year investment period, the pension fund is able to build up a highly diversified portfolio of privately held companies. These companies	

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- Private equity is a long-term asset class that focusses on the long-term growth of the companies in which it invests. Hence, it is very different to hedge fund strategies. The lifetime of a private equity fund is also typically around 10 years and as there are no possibilities for early redemption the companies receiving investments are given time to develop their growth strategies over many years.

- For assets such as private equity which are not publicly traded then, in accordance with accepted analytical methodologies, a mark-to-model rather than mark-to-market methodology should be taken. Without such a modification within the market-consistent framework for valuation, there is a risk that both IORPs and the broader health of the European economy will be adversely affected as a result of IORPs reducing or ceasing investment in private equity.

- EIOPA (and the Commission) have acknowledged that IORPs are suppliers of long-term capital to the European economy through investments in assets such as private equity. Private equity is an asset which benefits IORPs by being a return seeking asset and benefits the wider economy by providing long-term capital to the economy and helps build sustainable businesses. It is also an asset which is not publicly-traded and so has no recognized market value as required in a market-approach to valuation. But a simple and academically accepted modification, by means of the mark-to-model approach, would enable private equity to fit more logically within a market-consistent framework.

	• IORPs most generally gain exposure to private equity via a portfolio of unlisted funds. These unlisted funds do not have the characteristics required to apply a market-based approach to valuing them. But with a widely-recognized modification it is possible to fit a non-marketable asset class into market-based framework. • When it is not possible to use a market-based approach a mark-to-model approach is generally adopted, i.e. the valuation is identified by reference to benchmarking and extrapolation. It also requires independent verification of the values used. The private equity industry has set down international guidelines on valuation based on such an approach which have widely been adopted across the industry (and in academic research on the industry) and used for many years. • Unless a modified approach to determining the “market value” of private equity assets is taken within the HBS framework, then IORPs will be deterred from considering investing in the asset class on behalf of their beneficiaries. We believe this will have a detrimental impact for all stakeholders in the IORP, by reducing the scope to generate real returns to meet liabilities, thus potentially reducing security to beneficiaries and increasing costs. • In addition, if IORPs reduce their allocation or cease to allocate assets to private equity it will have a detrimental impact on the provision of long-term capital to European companies with the subsequent adverse consequences for the health of the European economy. In 2013, private equity industry invested more than EUR 35 billion in approximately 5,000 companies in Europe. More that 87% of all private equity investments are in SMEs and this is investment that yields real benefits for the economy.	

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