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Subject: CEA Key comments on Ceiops Consultation Papers CP63 to CP79

Brussels, 23 December 2009

Dear Carlos,

Thank you for giving us the opportunity to comment on Ceiops Consultation Papers 63 to 79 on the Solvency II - Implementing Measures (third wave).

In addition to our comments provided in the required templates, please find attached a list of CEA key comments related to the above Consultation Papers.

This list aims to provide an overview of our comments on the CPs, which should be considered in the context of all other CEA positions. These comments together constitute a coherent package. As such, the rejection of certain elements of our position is likely to affect the remainder of our comments. Also, these comments represent CEA views at the current stage of the project. As our work develops along with the development of the SII project, these views may evolve.

In addition, it should be noted that, in relation to the third wave of consultations, the excessively short deadline has limited the possibility for the industry to provide alternative solutions on all aspects on which we have concerns. However, we intend to deliver any further input as soon as is feasible.

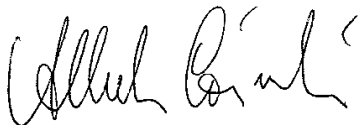
In responding to the previous waves of CPs, we had already stressed our serious concerns that the Ceiops' advice was not in line with the spirit and sometime the letter of the Framework Directive. In particular, it was characterised by a systematic injection of excessively conservative and prescriptive elements, whose cumulative effect would lead to a prudential regime that fails to achieve the objective of Solvency II and also implies undesired negative consequences for the functioning of the EU insurance market.

Ceiops' final advice on the first and second wave of consultation papers did not dissipate these concerns, as the industry input into the consultations was not sufficiently taken into account. Our concerns were further increased by the content of the third wave of CPs, which includes crucial aspects such as the calibration factors.

We appreciate the demanding workload and timeframe Ceiops has been asked to work with, but we strongly believe that a reconsideration of the overly conservative approach adopted up to now in advising the European Commission is absolutely necessary. We are confident that the attached comments, together with the comments already provided in relation to the previous two waves, will help to move the project in the right direction and we stand ready to discuss them with you. It is crucial that this happens soon, in order to identify balanced solutions, in line with the directive, well in advance of the final test to be carried out in QIS5.

The CEA remains committed to providing its contribution to the creation of a sound economic solvency framework for the European insurance industry and to working with all relevant institutions in the context of the definition of the Implementing Measures.

Yours sincerely,



Alberto Corinti
Deputy Director General / Director Economics & Finance

Encl.: ECO-SLV-09-640

Summary of key concerns on wave 3 CPs

CP63 - Draft L2 Advice on Repackaged loans investment

- 1. The prudent person principle defined in article 132 of the Directive, should prevail when investing in repackaged loan investments.**

In principle, we disagree with any restriction on investments which is considered to be a direct intervention of the supervisor in the management of the undertaking.

- 2. The requirements are difficult to apply in practice by undertakings in particular if they are required to duplicate the role of regulators.**

Ongoing assessment and control of 5% retention of originators and sponsors should be ensured by regulators to avoid duplication.

- 3. There is a risk of distressed sales.**

- a) If there is a binary yes/no recognition of such investments this could lead to distressed sales, even in cases where the breach is minor. The CEA proposes instead that any breaches of the requirements listed in this paper are assessed by undertakings and supervisors on case by case basis, as part of the Pillar II review.
- b) If grandfathering should cease to apply for repackaged loan investments where new underlying exposures are added or substituted would be too onerous and unworkable in practice. In particular, substitutions of the underlying exposures with a view to keep or increase the credit quality of the investment is in line with sound risk management practices and therefore should not be dis-incentivised.

CP64 – Draft L2 Advice on Extension of recovery period - Pillar II Dampener

- 1. When and how the definition of exceptional falls applies needs to be clearer.**

We do not agree with leaving these outside the scope of this paper. We are also concerned that it will be very rare for an exceptional fall to take place according to the criteria laid down in this advice.

- 2. It is unclear what constitutes a significant progress that undertakings need to make to restore their SCR.**

We understand that this is not within the scope of the CP but are of the view that harmonisation is essential in this area. In addition, we would like to emphasise that sometimes significant progress takes longer than three months.

- 3. The CP should give consideration to group perspective.**

The CP should consider what would be the impact on the group of one of the solo entities breaching its SCR.

CP65 – Draft L2 Advice on Partial Internal Models

1. The advice should recognise that the scope of PIM is best assessed by undertakings.

The definition of major business unit should ensure that undertakings are allowed and indeed encouraged to model homogeneous risks groups and lines of business individually. The key objective of the partial internal models should be improved assessment and quantification of risks. Such an approach has the advantage of allowing a more progressive and incremental approach to partial internal model development, which would make the development of such models more cost effective and therefore widespread

2. Companies should be allowed in the first instance, to use their own integration approaches.

As is assessed by Ceiops in CP74, the SF correlation approach has many weaknesses. Companies should therefore, as a first step within option 3, be allowed to use their own integration approaches with this being subject to supervisory review. However, where the large majority of a company's SCR is calculated using the standard formula approach, the CEA accepts that, within option 3, using the standard formula correlation matrix might be appropriate as a first step.

CP66 – Draft L2 Advice on Supervision of groups with centralised risk management

1. We do not agree that centralised risk management should be a pre-requisite for using a single ORSA and SFCR and in the future the group support regime, instead we believe that other types of equivalently efficient ways of organising group risk management should be able to meet the criteria.

We do not see centralised group risk management as the only efficient way of organising a groups' risk management and as such we believe that groups which do not follow a centralised risk management organisation should also be able to benefit from single ORSA and SFCR.

CP67 - Draft L2 Advice on Treatment of participations

1. Double gearing is addressed at group level and does not need to be addressed at solo level as well.

We strongly disagree with the treatment of participations in this CP as this addresses double gearing at solo level. We do not agree with excluding the own funds from financial undertakings and do not understand the rationale for penalising financial participations vis-à-vis non-financial unregulated participations. It is also unclear to us how the assessment of the eligibility of excess own funds of (re)insurance participations will be undertaken in practice.

2. In our view, all participations included within scope of group supervision should be treated as an equity investment at solo level and be subject to a reduced equity charge.

This approach would ensure consistency with article 109(ja) of the Directive, according to which the equity risk shock should be reduced in order to take into account the likely reduction in volatility due to the strategic and long term nature of the relationship and the influence exercised by the participating undertakings.

CP68 – Draft L2 Advice on Treatment of ring fenced funds

1. The definitions of Ring Fenced Funds proposed by Ceiops are not appropriate and both include funds which should not be considered as such.

In our view the following should NOT be considered as ring-fenced funds:

- Unit linked products
- Reinsurance
- General insurance profit sharing arrangements such as pooling, finites, equalisation reserves
- Guarantee scheme provisions
- In particular, ring-fenced funds should be limited to LIFE insurance products only. Furthermore, funds should not be considered ring-fenced if there are no direct policyholder rights to these funds.

Therefore, more analysis is needed to come up with an appropriate definition of Ring Fenced Funds which reflects the diversity of arrangements across EU markets. We would suggest Ceiops first considers, in cooperation with industry, the list of arrangements which should be treated as Ring Fenced Funds and then works towards principles to be included in level 2 which encompass these, and only these arrangements.

2. Ceiops suggested approach to the treatment of fungibility and diversification should not be imposed when an internal or partial model is used.

In particular firms should not be restricted from adopting more sophisticated approaches which allow for full one way diversification effects to be taken into account.

The own funds held within each ring-fenced fund can be split into two components, the part that belongs to policyholders and the part that belongs to shareholders. The shareholder part should be recognised in the own funds shown in the entity's balance sheet and should not be treated as policyholder funds.

3. It is important that proportionate approaches are available for the treatment of ring fenced funds, particularly where insurers have a large number of such arrangements.

CP69 – Draft L2 Advice on Design of the equity risk sub-module

1. The classification into “global” and “other” equities is not appropriate.

Currently the definition of “global” equities appears too narrow, as this classification could also be appropriate for equities listed on several other markets as well as for indirect holdings of these listed equities.

Furthermore, the classification of all other equities into the “other” category is inappropriate. There are significantly different risks across the assets currently included in “other” (e.g. infra-structure assets should be treated as property), therefore the stress should be split into a more granular segmentation.

2. The 45% (“global”) and 60% (“other”) stresses for the two proposed equity categories, moving to 55% and 70% respectively under certain circumstances due to the symmetric dampener mechanism, will result in unsustainable capital requirements.

3. The design of the equity volatility stresses is currently pro-cyclical and it is important that Ceiops ensures that there is no double-counting with the main stress for equity risk. For example:

- a) A multiplicative rather than an additive stresses mean that the stress is high under already stressed conditions;
- b) A constant stress to volatility rather than a more realistic short term, for example 1 year, stress;
- c) No allowance for correlation with the level stresses.

4. The dampener and duration approaches need to be complemented with Pillar II and III measures.

In this consultation document Ceiops presents more detailed guidance on the equity dampener and duration approaches. We support the aim of these approaches which is to mitigate pro-cyclicality. However, we should be careful to ensure that they do not deviate from the original 1 in 200 year shock and so inappropriately mask a breach of the SCR. In particular the Pillar I dampener needs to be carefully considered as its effects may exaggerate the stress faced by insurers at inappropriate points. We should ensure this mechanism delivers the right outcome which is to dampen stress conditions and not to make them worse. Finally, the presented approaches should always be supplemented by appropriate internal measures in Pillars II and III in line with the provisions set out in the Framework Directive, which do not appear to have been covered in this CP.

CP70 – Draft L2 Advice on Calibration of the market risk module

1. Ceiops proposes a significant increase in capital requirements for spread risk, which is 3.5 times larger than QIS4, however we believe that such changes in the level of the calibration cannot be justified by the crisis.

Furthermore, Ceiops has also proposed a less granular construction of this sub-module, proposing the same capital charge for bonds within certain duration buckets, which could be open to arbitrage and does not appear in line with a risk-based framework. We would propose to retain the QIS4 treatment for spread risk.

- 2. Under the currency risk module, the approach of taking the most onerous of up and down stresses for each currency with no correlation assumption between currency risks is more onerous than a 99.5 VaR calibration.**
- 3. Ceiops' approach to property risk takes no account of the different property risk seen across Members States and is based purely on property risk data from the UK market. We request a differentiated property risk calibration for each Member State.**
- 4. Furthermore, Ceiops' treatment of interest rate risk takes no account of the extrapolation method used to construct the yield curve (i.e. if the long-end of the curve is based on a macro-economic method there would be little volatility at the long end, however Ceiops proposes large stresses across the curve), while and spread risk module makes no allowance for a liquidity premium.**
- 5. The design of the interest rate volatility stresses is currently pro-cyclical and it is important that Ceiops ensures that there is no double-counting with the main stress for interest rate risk. For example:**
 - a) A multiplicative rather than an additive stresses mean that the stress is high under already stressed conditions;
 - b) A constant stress to volatility rather than a more realistic short term, for example 1 year, stress;
 - c) No allowance for correlation with the level stresses.

CP71 - Draft L2 Advice on Calibration of the non-life underwriting risk

- 1. In general, we found that the data and the methods used by Ceiops in coming up with the proposed calibration for the Non-Life underwriting risk present a number of important drawbacks:**
 - a) **The data comes from 6 countries only, with data from major markets missing and as such fails to be representative of the EU market.** For certain lines of business where data is very scarce and is only based on a very limited number of undertakings, we have major concerns about the validity

of the results. We feel that the standards on the appropriateness, completeness and accuracy of data, set by Ceiops itself in CP43, are not met.

- b) **In addition to our concerns related to the scarcity of data, we have strong concerns about the quality of the data used.** Indeed, in many instances the data used appears to be of very little quality. Many sources of heterogeneity have been ignored in the analysis including changes in reinsurance programmes, and many differences between countries such as claims environment, accounting basis and regulation. Also gross and net of reinsurance data are inconsistently used making the results incomparable.
- c) **A transparent, reproducible and consistent approach is lacking in using the different methodologies for the calibration of the reserve and premium risks.** The assumptions behind the different methods have not been given sufficient consideration. In addition, the selection of the ultimately applied method is not always sufficiently substantiated.

2. Geographical diversification and non-proportionnal re/insurance should be explicitly and not implicitly allowed for.

It is not clear how the recognition of these key risk mitigation techniques has been allowed for implicitly in the proposed calibration. The standard formula should not fall short of incentivizing sound risk management.

CP72 – Draft L2 Advice on Calibration of the health underwriting risk

1. Differences in laws and in the organisation between public and private health systems across Europe have consequences on the variety of products offered in each Member State which need to be recognised in the Health underwriting risk module.

These significant differences have not been considered sufficiently in the calibration which will imply very onerous capital requirements in certain countries or will push undertakings into using expensive internal models:

- a) For the part of the health UW risk module similar to non life UW risk, the calibration analysis has similar drawbacks, in terms of the data and methods used, to the drawbacks highlighted in our comments to the Non-Life UW risk module calibration CP (data from only few countries was used, u/w cycles have not been considered...).
- b) For the part of the health UW risk module similar to life UW risk, no specific calibration has been performed whereas the risks are significantly different between life and health products. For example lapse risk for health products may have lower volatility when the option of policyholders to stop the contracts is constrained by law under some regimes.

However, we believe that there are possible ways of overcoming these shortcomings that need to be considered, such as:

- a) Undertaking Specific Parameters are a way of recognising Member State specificities.
- b) The use of country specific factors or different factors per buckets of health products should also be considered for the health risk module.

2. As previously mentioned as part of our comments on CP50, the design of the health UW risk module should stick to point A of the Annex I of framework directive which clearly distinguishing between "Accident" and "Sickness" cover.

CP73 – Draft L2 Advice on Calibration of the MCR

1. The calibration of the MCR should be discussed in the light of QIS5 results.

CP74 – Draft L2 Advice on Correlation parameters

1. This advice alone would result in an increase in capital requirements of 25% on average compared to QIS4 and Ceiops' proposals are excessively prudent and often not based on sufficient (or any) analysis.

It inappropriately restricts the diversification benefits, particularly arising from diversifying asset investments and so is not providing the correct incentives for insurers.

2. Ceiops has proposed positive correlations for all independent risks (for example for market concentration risk compared to the other market risks, for lapse risk compared to mortality risk) without sufficient justification – these were all appropriately set to zero in QIS4.
3. Furthermore, Ceiops proposes significant increases to the correlations between equity and spread risk and between equity and interest rate risk, however our study¹ suggests different (lower) correlations between these risks.
4. Bi-directional risks should not be assumed to have the same correlations with other risks independent of whether the up or down shock is the biting scenario, for example it would be inappropriate to assume that interest rate down shocks have the same correlation with equity falls as interest rate up shocks.
5. We would not expect any automatic write-across of these correlation assumptions to Internal Models.

CP75 – Draft L2 Advice on Undertaking specific parameters

1. The use of undertaking specific parameters should not be restricted in terms of the scope of risks which are covered and the methods which can be used.

By definition, undertaking specific parameters are allowed where they better reflect the risk profile of undertakings and as such we do not see any valid reason why their use should be de facto restricted to pre-defined lists of methods to be used and risks to be modelled. For example, undertakings should be able to use undertaking specific parameters for risks such as lapse, longevity and expense risk (this list is not exhaustive).

The restriction of methods to the “standard methods” proposed in this CP will, in most cases, make it impossible to obtain valid results, as these “standard methods” have severe limitations as discussed in our comments to CP 71 and CP72. We believe that there isn't an optimal alternative that should be selected as the only alternative to determine USP, and as such undertakings should be able to propose more appropriate methods for calibrating USP subject to supervisory approval.

2. The weights given to USP in the credibility weight approach do not provide enough incentives for undertakings to develop parameters which by definition better reflect their risk profile.

More weight should be given to USPs. Indeed, as highlighted in our comments to CP71 and CP72 the proposed methods and the data used present a number of major drawbacks such as the fact that they do not make any allowance for the underwriting cycle. Therefore, we do not see any reason why the standard factors should de facto be given more weight.

1. http://www.cea.eu/uploads/DocumentsLibrary/documents/1260528556_cea-background-note-on-ceiops-cp74-09-historic-market-risk-correlations.pdf

Furthermore, we believe that allowing for 100% weight on USP only when 15 years of data is available is excessive. Instead, consideration should be given to the introduction of requirements in terms of number of years of data which would depend on the type of business which is being considered.

3. We propose that a sliding transitional mechanism could be put in place in order to ensure a smooth transitioning to Solvency II.

We believe there will be cases where companies will not have sufficient data in order to comply with these requirements when Solvency II comes into force and will therefore not be able to use as much

entity specific parameters which by definition better reflect their business. Therefore, we propose that a sliding transitional mechanism could be put in place in

order to ensure a smooth transitioning to Solvency II. In practice this could mean that instead of allowing undertakings to use a 100% weight factor for their entity specific parameters only when the required years of historical data are available, undertakings are allowed to use a 100% weight factor with a reduced number of historical data at the entry in force of Solvency II. This reduced number of years of historical data would increase by a year every year after to reach the number of years required by the legislation.

CP76 – Draft L2 Advice on Simplifications for Technical Provisions

1. Simplifications should not be restricted to a list of formulae under Level 2.

As was evidenced by their use in the QIS4 exercise, there is a need for a wider range of simplifications and proxies than those considered in this document.

The possible simplifications that could be used by undertakings should not be restricted to the simplifications suggested in this consultation paper. Undertakings should be allowed to use simplifications whenever it's duly justified.

Simplifications are likely to be needed for discounting. More basic simplifications, perhaps incorporating a degree of conservatism, are also likely to be needed in a range of areas.

2. The “simplifications” include approaches that would not be considered simplifications and in some instances would be considered disproportionately complex.

The focus should be on simplifications as opposed to possible approaches. The standards being set by Ceiops should not be too restrictive or difficult to assess elements such as the loss absorbing capacity of technical provisions.

Also, the proportional approach should be declared the default method for the calculation of the risk margin.

3. Undertakings should not be required to calculate the model error of the simplifications they use.

It needs to be made clear in the level 2 text and throughout this document that undertakings are not expected to perform significant additional calculations (e.g. using more sophisticated approaches) in order to assess the potential impact of model error as doing so would be disproportionate and defeat the objectives of having simplifications.

CP77 – Draft L2 Advice on SCR Standard Formula – Simplified calculations in the standard formula

1. Should not be restricted to a list of formulae under Level 2.

The possible simplifications that could be used by undertakings should not be restricted to the simplifications suggested in this consultation paper. Undertakings should be allowed to use simplifications whenever it's duly justified.

To that extent, we do not support the omission of any simplifications, for example spread risk or interest rate risk simplifications.

2. Undertakings should not be required to calculate the model error of the simplifications they use.

It needs to be made clear in the level 2 text and throughout this document that undertakings are not expected to perform significant additional calculations (e.g. using more sophisticated approaches) in order to assess the potential impact of model error as doing so would be disproportionate and defeat the objectives of having simplifications.

CP 79 – Draft L2 Advice on Simplifications for Captives

1. The key requirement for any simplification should be the nature, scale and the complexity of the risks inherent to the business of insurance/reinsurance undertakings and not the legal status of undertakings.

We therefore propose not to treat captives separately and rather merge these simplification proposals with CP 76 and CP 77.