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CEIOPS Financial Requirements Expert Group: work programme 2009

1. Mandate

The Expert Group takes over the mandate of the former Pillar I expert group with exclusion of internal model related matters. The Expert Group is also mandated with the preparation and execution of Quantitative Impact Studies in the context of the Solvency II project.

Mandate

The tasks of the Expert Group are

- to conduct preparatory work on the standard requirements of financial resources and adequacy of technical provisions for life and non-life insurance business, in line with the design of the Solvency II prudential system;
- to deal with the formulation and analysis of approaches, models and methods for the capital requirements (MCR and SCR standard formula) and valuation of technical provisions, and in particular to look into aspects of practicability, including simplifications where appropriate;
- to prepare and execute quantitative analysis necessary to calibrate the Pillar I standards and assess their impact;
- to act as an information sharing platform in the field of experience with solvency requirements and technical provisions within the EU/EEA.

2. Priorities of the expert group in 2009

2.1. Solvency II Level 2 Implementing Measures

i. Delivery of advice for the Level 2 implementing measures to the EC by October 2009.[1]

[1] See letter from the EC of 19 July 2007. In its workplan, CEIOPS foresees publishing the bulk of its Level 3 guidance necessary for the entry into force of Solvency II by the end of 2010, the latest by Spring 2011 (18 months before the implementation of the Solvency II Framework).

- Identify and validate in QIS4 technical specifications and previous advice the relevant material for inclusion in the Level 2 Advice and Impact Assessment.
- Timing and structure of the advice:
  - o At least two sets of advice will be released for two to three months consultation periods in 2009 after CEIOPS' March and June Members Meetings.
  - o The basis of the work is the Amended Solvency II Directive Proposal from February 2008.[2] Pending the final approval of the Level 1 Directive by the Parliament (foreseen for April 2009), advice on some debated issues may depend on the final text of the Directive.
- Liaison with the CEIOPS - Groupe Consultatif Coordination Group on Non-Life Best Estimate on the development of the Level 2 and Level 3 measures for the non-life best estimate.

ii. Impact assessment ("IA")

- CEIOPS' advice will be accompanied by an impact assessment which will serve as an input for the European Commission's impact assessment on Level 2 measures.

2.2. Support to CEIOPS training activities

FinReq will continue providing input in the seminars and training sessions organised by CEIOPS on issues that are of relevance to the expert group.

3. Organisation and structure

3.1. Chair

Pauline de Chatillon (ACAM, France)

3.2. CEIOPS Secretariat

Pamela Schuermans (secretariat@ceiops.eu)

3.3. Technical provisions subgroup (TP sg)

Deliverables:

a. Implementing measures (Art. 85) and Level 3 guidance.

Methods for best estimate; risk-free interest rate term structure; hedgeable versus non-hedgeable obligations ; risk margin; segmentation; data standards and case-by-case approach; counterparty default; simplifications for technical provisions.

[2] COM (2008) 119 final.

3.4. Own funds subgroup (OF sg)

Deliverables:

b. Implementing measures (Art. 92, Art. 97, Art. 99) and Level 3 guidance.

Supervisory approval of ancillary own funds; treatment of participations in financial and credit institutions; division into sub-tiers, if necessary criteria to classify own funds into sub-tiers; list of own funds; supervisory approval, assessment and classification of own fund items; limits for sub-tiers, if necessary.

3.5. SCR subgroup (SCR sg)

Deliverables:

c. Implementing measures (Art.103, art. 109 para 1 (with reference to art. 104, 105, 106, 107 and 108) and Level 3 guidance.

Sub-modules; design and parameters of risk modules and sub-modules of BSCR; correlations ; risk mitigation techniques; qualitative assessment of risk transfer; operational risk; loss-absorbing capacity of technical provisions; the standard parameters that can be replaced with entity specific parameters; methods for calculation of the entity specific parameters; simplifications

3.6. MCR subgroup (MCR sg)

Deliverables:

d. Implementing measures (Art. 128 (with reference to art. 126) and Level 3 guidance.

Design and calibration of MCR

4. Deliverables and deadlines for Level 2 implementing measures

Issue, reference and description of issue[3]		Priority[4]	Draft advice
TECHNICAL PROVISIONS			
Article 85[5] (a)	actuarial methods and statistical techniques to calculate the best estimate referred to in Article 76(2);	High	March 2009 (methods to calculate BE) Other issues: June 2009
Life technical provisions		High	
Description of main characteristics to calculate BE (deterministic approach, stochastic approach, for reinsurers)			
Future discretionary bonuses/benefits (definition, useful tool to managing, splitting TP between discretionary and guaranteed, modelling legal requirements of profit participation, difficulties of modelling part form mortality and expense result))			
Management action points (how to take them into account under stress scenarios)			
Options and guarantees (how to value) (observable policyholder behaviour not consistent with no arbitrage principle)			
Future premiums (definition and treatment i.e. riders, contracts with variable contributions, expected renewals, tacit renewal options, allowance for future premiums for next 12 months)			

[3] The basis for the identification of the Level 1 implementing measures is the Level 1 Directive proposal from February 2008. At some occasions however, some minor adjustments have been made to take into account the Council compromise agreed under the Slovenian presidency in June 2008.

[4] The priorities are being established having regard to the importance of the issue (a crucial issue has a high priority). The deadlines are broadly divided according to two phases of consultation (following March and June Members' Meetings). Timing of the advice may be subject to change following decisions on the Level 1 text and the progress of the work.

[5] EC strongly recommends Level 3 Guidance on Article 85 (see annex to letter from EC of 19 July 2007). In its workplan, CEIOPS foresees publishing the bulk of its Level 3 guidance necessary for the entry into force of Solvency II by the end of 2010, the latest by Spring 2011 (18 months before the implementation of the Solvency II Framework). However, on certain issues, depending on the stage of the work and the relevance for the implementation, FinReq can aim at outlining potential Level 3 guidance accompanying the Level 2 advice by October 2009.

Issue, reference and description of issue[3]		Priority[4]	Draft advice
Assumptions (mortality, morbidity, expense, entity specific assumptions, unrealised economic of scale when setting expense assumptions for start-up companies)			
Policyholders behaviour (lapses and surrenders)			
Treatment of short term death or disability business (participation profit; mitigation effects)			
Calculating reinsurers part (particular non-proportional part); valuation of ceded and assumed reinsurance			
Taking into account taxations			
Non-Life technical provisions		High	
Description of main characteristics to calculate BE (deterministic approach, stochastic approach, confusion over whether traditional methods regarded as simplifications, methods for reinsurers; Highlight the cash-flows of future expected reimbursement, recoverable)			
Calculating reinsurers part (particular non proportional part); valuation of ceded and assumed reinsurance			
Future premiums (definition and treatment multiple years contracts, tacit renewal options, allowance for future premiums for next 12 months)			
Allowance for expected claims inflation			
Incurred large claims or claims of exceptional nature			
Premium provisions (stand-ready obligations, future large claims - weights to place to future large claims)			
How to take into expected cash-flow future bonuses and rebates			
Long tailed non-life insurances (non-life annuities)			
Entity specific assumptions (unrealised economic of scale when setting expense assumptions for start-up companies)			
Management actions - Risk mitigation effects where yearly ability to change premium			
Article 85(b)	the relevant risk-free interest rate term structure to be used to calculate the best estimate referred to in Article 76(2);	High ***Issue for IA***	June 2009
Options for determining the risk free term structure			

Issue, reference and description of issue[3]		Priority[4]	Draft advice
Proposed methodology to determine risk free term structure			
What yield curve used for cross-border business			
Need for real yield curve for index linked products			
Article 85(c)	the circumstances in which technical provisions shall be calculated as a whole, or as a sum of a best estimate and a risk margin, and the methods to be used in the case where technical provisions are calculated as a whole;	High	June 2009
Define circumstances in which TP calculated as a whole			
Methods to be used in case where TP are calculated as a whole			
Article 85(d)	the methods and assumptions to be used in the calculation of the risk margin, including the determination of the amount of eligible own funds necessary to support the insurance and reinsurance obligations and the calibration of the Cost-of-Capital rate;	High ***Issue for IA***	June 2009
Methods to be used in the calculation of risk margin. Including: How to calculate future SCR (deferred taxes, future profit sharing, market risk for non-hedgeable financial risks) and determination of amount of eligible own funds necessary to support the (re)insurance obligations (define the future SCR)			
Segmentations of business within risk margins; Diversification between lines of business & diversification between non-hedgeable risks; (how to take into account riders)			
Non-life catastrophe risk			
Calibration of the Cost-of-Capital rate			
Long-tailed non-life insurance - problems with projecting SCR or underlying cash-flows and provisions into future			
Helper tab produce separate risk margin for premium and claims provisions; not working properly for negative TP			

Issue, reference and description of issue[3]		Priority[4]	Draft advice
Simple risk margin proxy for non-life produce too high result			
Risk margin reduced via internal reinsurance			
Article 85(e)	the lines of business on the basis of which insurance and reinsurance obligations are to be segmented in order to calculate technical provisions;	High	March 2009
Clarification of segmentation			
Splitting the data of business: Proportional and non-proportional treaties, historically motor products as a package of "motor liability" and "motor other"			
Article 85(f)	the standards to be met with respect to ensuring the appropriateness, completeness and accuracy of the data used in the calculation of technical provisions, and the situations in which it would be appropriate to use a case-by-case approach to calculate technical provisions;[6]	Medium	June 2009
Which data collected			
Quality of data			
Data to produce own experience mortality, disability tables			
Data for modelling lapses			
Data for valuing options and guarantees			
Situation to use case-by-case approach to calculate TP			
Splitting the data among lines of business			
Segmentation data by geographical area			

[6] Council Compromise redraft: […] and the specific circumstances in which it would be appropriate to use approximations, including (…) case-by-case approaches, to calculate (…) the best estimate.

Issue, reference and description of issue[3]		Priority[4]	Draft advice
Allocate proportional part of assumed reinsurance business to relevant line of business			
Own experience versus industry/market data for assumptions on expenses, other entity specific provisions; use own company experience, underwriting and servicing costs for estimating liabilities			
Inconsistencies in data due to changes			
Article 85(g)	the methods to be used when calculating the counterparty default adjustment referred to in Article 80 designed to capture expected losses due to default of the counterparty;	Low	June 2009
Methods to be used when calculating counterparty default risk			
Article 85(h)	where necessary, simplified methods and techniques to calculate technical provisions, in order to ensure the actuarial methods and statistical techniques referred to in point (a) are proportionate to the nature, scale and complexity of the risks supported by insurance and reinsurance undertakings.	High	June 2009
Simplified techniques to calculate TP			
Discounting in the case where there are no cash flow patterns (how to take into account riders)			
Develop more precise criteria under which simplifications and proxies would be applied			
Life insurance			
OWN FUNDS			
Article 92.1(a)	the criteria for granting supervisory approval of ancillary own funds in accordance with Article 89 (AOF);	Low	March 2009

Issue, reference and description of issue[3]		Priority[4]	Draft advice
Article 92.1(b)	the treatment of participations, within the meaning of the third subparagraph of Article 210(2), in financial and credit institutions with respect to the determination of own funds.[7]	High ***Issue for IA.***	June 2009
Article 92.1(c)	the treatment of related insurance and reinsurance undertakings within the meaning of paragraphs 1 and 2 of Article 210.	Medium	June 2009
Article 97.1(a)	*the division of tiers into sub-tiers;*	PM	PM
Article 97.1(b)	*the criteria used to classify own fund items into the sub-tiers referred to in point (a) based on the characteristics set out in Article 93;*	PM	PM
Article 97.2(a) [8]	a list of own fund items deemed to meet the criteria, set out in Article 94 and in point (b) of this paragraph, which contains for each own fund item a precise description of the features which determined its classification;	High ***Issue for IA.***	June 2009
Article 97.2(b)	the methods to be used by supervisory authorities, when approving the assessment and classification of own fund items which are not covered by the list referred to in point (c).	Low	June 2009
Article 99	*specific limits applicable to sub-tiers, where sub-tiers have been introduced.*	PM	PM

[7] Inserted by the Council compromise.
[8] The Slovenian Council compromise has split Article 97 into subsection 1 (*may*) and subsection 2 (*shall*).

Issue, reference and description of issue[3]		Priority[4]	Draft advice
SCR			
General	Calibration of risk modules, simplifications, correlations, use of credit ratings and treatment of ring fenced funds	High	June 2009
Article 102bis with reference to Article 210[9]	Treatment of related undertakings in the calculation of the SCR	High	June 2009
Participations			
Article 109(a), (b) and (c)	standard formula in accordance with provisions of Articles 101 and 103 to 108[10]; any sub-modules necessary for covering more precisely the risks which fall under the respective risk modules referred to in Article 104 as well as any subsequent updates; the methods, assumptions and standard parameters to be used, when calculating each of the risk modules or sub-modules of the Basic Solvency Capital Requirement laid down in Articles 104 and 105.	High	See individual risk modules
Market risk		High	March / June 2009 (for equity risk, use of credit ratings)
Rationale for the calibration, definition of the risks and the shocks			
Equities ***Issue for IA***			

[9] Introduced by the Slovenian Council compromise.
[10] Introduced by the Slovenian Council compromise (move from previous Article 103).

Issue, reference and description of issue[3]	Priority[4]	Draft advice
Cyclic equity dampener		
Other cyclic dampeners		
Use of credit ratings		
Interest rate: introduction of shocks on the yield curve's shape		
Allowance for the expected profit in the market risk module		
Introduction of shocks on the variation of volatility in the market risk module		
Currency risk: further refinement to prevent the masking of shocks through "hedging" between two different currencies		
Concentration risk: harmonised treatment of covered bonds		
Concentration risk: treatment of UCITS		
Concentration risk: property		
Mapping of financial risks		
Inflation risks		
Market correlations		
Simplifications		
Counterparty default risk	High	March 2009
Design of counterparty default risk module		
Simplification LGD		
Use of credit ratings		
Treatment of intermediaries (and similar counterparties)		
Scope of the module		
Co-insurance and reinsurance pools		
Dedicated reinsurers (P&I Clubs)		
Guarantees and facilities		

Issue, reference and description of issue[3]	**Priority[4]**	**Draft advice**
Simplifications		
Life underwriting risk ***(Underwriting risk in general: issue for IA)***	Medium	March 2009
Best practices for the use of homogeneous risk groups		
Differentiation of biometric shocks by age brackets		
Disability risk: treatment of recovery rates		
Mortality risk: bundling/unbundling of contracts		
CAT risk: inclusion of disability risk: offsetting of mortality and longevity risk		
Lapse risk: mass lapses, dependencies, unit linked products		
Life correlations		
Calibration: Lapse, longevity		
Simplifications		
Health underwriting risk	Medium	June 2009
Review of the design according to the final Directive wording		
Annuities: fair and equivalent treatment for motor and workers' comp. annuities		
Calibration and CAT issues		
Health correlations		
Simplifications		
Non-life underwriting risk	High	June 2009
Is it possible to overcome the problem of tariff increase leading to a SCR increase		
How do we provide a practical solution of taking non-proportional reinsurance into account?		
Distinction between premium and reserve risk and CAT risk		
Premium and reserve risk		
Allowance for the uncertainty in the determination of the premium reserve in the SCR		

Issue, reference and description of issue[3]			Priority[4]	Draft advice
Harmonized definition of LoBs: cfr. TP sg				
Calibration				
CAT risk: methods to be adopted				
CAT risk: consistency across EU				
CAT risk: undertaking specific parameters				
Allowance in the SCR for additional uncertainty caused by the used of proxies				
Correlations				
Simplifications				
Article 109(d)		the correlation parameters;[11]	Medium	June 2009
Inter module correlation matrix (annex IV)				
Article 109(e)		where insurance and reinsurance undertakings use risk mitigation techniques, the methods and assumptions to be used to assess the changes in the risk profile of the undertaking concerned and adjust the calculation of the Solvency Capital Requirement;	Medium	June 2009
Valuation of risk mitigation instruments, processes, management actions under scenario assumptions: Treatment of "tail" commissions. Introduction of the impact of profit sharing with the NL reinsurers. Adjustment for deferred taxes. Lower boundary SCR calculation				
Review of principles				
SCR	Article 109(f)	the qualitative criteria that the risk mitigation techniques referred to in point (e) must meet in order to ensure that the risk has been effectively transferred to a	Medium	March 2009

[11] See annex IV of the Directive proposal.

Issue, reference and description of issue[3]			Priority[4]	Draft advice
		third party;		
SCR	Article 109(g)	the methods and parameters to be used when assessing the capital requirement for operational risk set out in Article 106;[12]	Low	June 2009
Calibration				
SCR	Article 109(h)	the method to be used when calculating the adjustment for the loss-absorbing capacity of technical provisions, as laid down in Article 107;	Medium ***Issue for IA***	June 2009
Modular or equivalent scenario based calculation				
Keeping the "gross" calculation				
Allowance for the change of the CoC margin under stress in the SCR				
Clarification of the phrase: "the assumptions of future bonuses remain unchanged"				
SCR	Article 109(i)	the subset of standard parameters in the life, non-life and special health underwriting risk modules that may be replaced by undertaking-specific parameters as set out in Article 104(7);	Medium	June 2009
Methodologies				
SCR	Article 109(j)	the standardised methods to be used by the insurance or reinsurance undertaking to calculate the undertaking-specific parameters referred to in point (i), and any criteria	High	June 2009

[12] Council Compromise insertion: […] as well as the fixed percentage referred to in paragraph 3 of Article 106.

Issue, reference and description of issue[3]			Priority[4]	Draft advice
		with respect to the completeness, accuracy, and appropriateness of the data used that must be met before supervisory approval is given;		
Standardised methodology				
SCR	Article 109(k)	the simplified calculations provided for specific sub-modules and risk modules, as well as the criteria that insurance and reinsurance undertakings shall be required to meet in order to be entitled to use each of these simplifications, as set out in **Article 108**.	High	June 2009
Methodology and calibration				
Captives				
Criteria for use of simplifications				
MCR	Article 128	The Commission shall adopt implementing measures specifying the calculation of the Minimum Capital Requirement, referred to in **Articles 126 and 127**.	High ***Issue for IA***	June 2009
Splitting the combined MCR into notional life and non-life components				
Calibration of the linear formula				
Quarterly calculation of the MCR				