

Solvency II Pillar 1 Working Group



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Dear Annette,

Solvency II: Technical Provisions

As you know, the CEIOPS Pillar 1 Working Group is currently developing proposals to test in a second quantitative impact study (QIS2). QIS2 will include possible methods and approaches for the calculation of adequate capital requirements, as well as potential standards for the valuation of assets. The valuation of technical provisions will be addressed for a second time, although the intention is to test fewer approaches than under QIS1.

Given the timing of QIS2, it is expected that the results will be instrumental in shaping the Commission's first draft proposal for the Solvency II Directive. In October 2006, CEIOPS is aiming to give further advice to the Commission on a number of Pillar 1 aspects – including technical provisions – on the basis of the QIS2 results.

Last week, you outlined how your working group had developed a piece of comparative analysis on three broad approaches to technical provisions, namely

- a **percentile approach**, as described in the European Commission's *Framework for Consultation on Solvency II* and further developed by CEIOPS in its technical advice;
- a **cost of capital approach**, similar to that underlying the Swiss Solvency Test and which is also advocated in the CEA / CRO Forum's *Solutions to major issues for Solvency II*; and
- a **benchmarking approach**, where the risk margin is generated by applying a factor to the best estimate.

You explained that the working group's paper evaluated these three approaches against a set of criteria, representing suitable characteristics for a standard on technical provisions. The aim was not to make recommendations, but rather to provide a broad overview of the advantages & disadvantages of each approach. The analysis also highlights the challenges that would need to be overcome if any of these approaches were to become operational under Solvency II.

The CEIOPS Pillar 1 working group and the CEIOPS Financial Stability Committee will be meeting in Paris on 14 & 15 February to develop the QIS2 proposals on technical provisions. The analysis produced by your group would be an extremely valuable basis for that discussion.

Given the time constraints, I recognise that any paper shared with CEIOPS would need to be understood as 'work-in-progress' rather than a formal statement of position by the Groupe Consultatif.

Many thanks for your ongoing contribution to our work.

Best regards,

A handwritten signature in black ink, appearing to read 'Sam McAuliffe', written in a cursive style.

Sam McAuliffe
on behalf of Paul Sharma (Chairman)