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15 September 2006

Mr Henrik Bjerre Nielsen  
Chairman  
CEIOPS

Dear Henrik

**Comments on CEIOPS Consultation Papers CP13 and CP14**

We have pleasure in attaching below the comments of the Groupe Consultatif on CEIOPS draft answers contained in Consultation Papers CP13 and CP14.

**CP 13: Draft Advice to the European Commission in the framework of the Solvency II project on insurance undertakings' Internal Risk and Capital Assessment requirements, supervisors' evaluation procedures and harmonised supervisors' powers and tools**

In CP 13, CEIOPS elaborates on proposals sketched out in its answers to the Commission's CFAs. This paper is an important step in the progressive shaping of the supervisory system under Solvency II, and the Groupe is happy to have been given the opportunity to comment on CEIOPS' suggestions.

Before coming to detailed comments on each paragraph, we would draw CEIOPS' attention to three main comments:

- 1) The Groupe welcomes the proposal about a requirement of Internal Risk and Capital Assessment (IRCA). We consider this as an important part of the risk management of an insurance undertaking which at a later stage should be outlined in a more detailed way (as CEIOPS already noted in paragraph 10)

Clarification is required on whether IRCA is expected by all companies independent of whether internal models are used for the SCR or not. In addition, we are concerned that the wording of paragraphs 19 - 22 could lead to misunderstanding of the scope of IRCA.

- 2) CP 13 proposes that supervisory authorities are granted extensive powers of assessment (paragraph. 25 - 27, 30, 32 - 34 and 37). As assessments do not rely on a sole indisputable methodology, it is important that the undertaking be given the opportunity to comment on the supervisor's assessments prior to any conclusion or sanction based on these assessments. This principle should be laid down in CP 13.
- 3) We agree that capital add-ons are an exceptional solution and should be seen as a last resort if no other measurement seems viable. CP 13 brings precision to Pillar II capital add-ons (paragraphs 37 - 43). However, it is of utmost importance that the application and calculation of add-ons will be consistent across national markets and across the whole EU market. In order to avoid supervisory arbitrage, CEIOPS should provide a common set of principles for application and calculation of the different classes of add-ons and other supervisory powers.

In addition the Groupe proposes that there should be some commitment by CEIOPS to anonymised reporting to stakeholders on the use of add-ons (see our comment on paragraph 42).

Subject to the above comments, the Groupe generally supports the proposals set out in CP 13. However, we add a few comments on the wording of some paragraphs:

*Paragraph 6*

The quantitative measurement of risks cannot be required for *each risk identified* because it is impossible for certain risks (e.g. operational risks).

*Paragraph 8/9*

The second bullet point needs clarification. If a company uses an approved internal model, the risk profile will normally differ from the implicit risk profile of the standard approach. Therefore in this case there should be no add-on requirements for this difference.

*Paragraph 13*

It is important that we get a minimum set of powers that all supervisors shall have in order to avoid arbitrage.

*Paragraph 15*

We agree that capital add-ons are an exceptional solution and should be seen as a last resort if no other measurement seems viable.

*Paragraph 21*

What is meant in practice by permanent checks and how can this be done in a harmonised way in all European countries?

*Paragraph 25*

It would be helpful if the list of risk classes (some of them may be overlapping, for example strategic risk vs. operational risk) could be clearly defined before further use in discussion.

*Paragraph 31*

*Failing* should be defined.

*Paragraph 33*

The approval of an internal model might prove to be a long and complex procedure; to avoid inappropriate delays, we propose that this approval process should not exceed a predefined time limit. More information is required on the envisaged approval process. It would also be essential that, in case of refusal or withdrawal of the approval of an internal model, the undertaking will be informed of the reasons of this decision.

*Paragraph 42*

We agree with CEIOPS that a public disclosure of Pillar II capital add-on should not be required. However, we propose that, in an anonymised way, each supervisory authority publishes, on a regular basis, data about add-ons (e.g. the number of companies with and without add-ons, the total amount as a percentage of the Pillar I SCR-requirements). This could help in the forthcoming years to harmonise the Pillar II requirements within Europe and avoid regulatory arbitrage.

*Paragraph 45*

We suggest changing the wording of the title "Breach of the SCR" to "Non-fulfilment of the SCR" because SCR is only a reference and not a hard limit like the MCR.

## **CP14: Draft Advice to the European Commission in the framework of the Solvency II project on sub-group supervision, diversification effects, cooperation with third countries and issues related to the MCR and SCR in a group context**

As a general remark we would like to recommend that the roles of the various supervisors (local vs group) be specified in a more detailed way. This could help to avoid duplicating work both for the supervisors and also for the companies.

### ***Group diversification***

#### *Paragraph 2.7 / 2.9*

We are pleased to see CEIOPS' recognition of the principles of diversification at group level and agree that this is a challenging area for supervisors.

#### *Paragraph 2.21*

CEIOPS seems to be converging on the concept of "contingent capital" to solve the problem of allocating the value diversification effects from a group level to solo entities. Care needs to be taken when reviewing on a solo basis a company that has committed "contingent capital". We assume that in this case the contingent capital is not regarded as a liability for the group level and is therefore not deducted from the eligible capital of the group.

#### *Paragraph 2.24*

We agree with a list of conditions for allowing the use of diversification effects. We have only the following remarks:

- 2.24 d refers to the provision of cash resources. In our opinion cash does not seem to be necessary: admissible and eligible assets should be sufficient to provide capital support by the parent undertaking.
- In 2.24 i we cannot see the logic for centralised risk management being a prerequisite, even if we see the value of having such a function.

#### *Paragraph 2.25*

We would caution that applying a standard formula to group consolidated data may not enable recognition of all sources of diversification or co-dependence. On the one hand, this depends on the level of differentiation retained in the formulas, and, on the other hand, on the understanding of consolidated data and the level of segmentation retained in the data. From an accounting perspective, it would be natural to add together, for example, all property business. But that might mean adding property in Portugal to that in Sweden and Australia, so obscuring a source of diversification.

#### *Paragraph 2.28*

We would encourage CEIOPS to consider carefully the design of the group SCR formula and the treatment of group diversification. We have previously commented on this in our paper on "Group diversification".

### ***Groups with third country connections***

#### *Paragraph 3.17*

The expression "standard model" should be changed to "standard approach".

#### *Paragraph 3.25*

The expression "standard model" should be changed to "standard approach".

This paragraph refers to the situation where a part of the group is in a third country which does not have an equivalent regime and proposes that the group regulator should require the use of a standard approach for these parts of the group. We would advise that applying standard formulas designed for an EU market could lead to erroneous outcomes when applied to other markets where a variety of attributes could be different, e.g. policy conditions, legal systems, product design, mix of product features within a segment (e.g. prevalence of financial options). A well-justified internal model would be preferable.

***MCR and SCR in the group context***

*Paragraph 4.4*

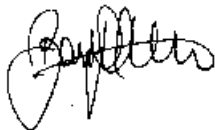
The meaning is not clear to us.

*Paragraphs 4.7, 4.8*

We suggest that the proxy MCR (being the sum of the solo MCRs) is taken as a definition for the floor of the group SCR. Therefore the factor in 4.8 should be one. Independently of this remark we see a danger that the MCR (or, in a group, the floor of the SCR) and the SCR are too close to each other. There are two possible causes for this. The first results from two different approaches being used within a group (standard approach for the MCR and the SCR calculated by an internal model). The second results from the lack of recognition of group diversification effects for the proxy MCR of a group, especially if, for the calculation of the solo SCR (and solo MCR), no group diversification effects are taken into account as proposed by CEIOPS in 2.14 and 2.30. If the MCR (or, in a group, the floor of the SCR) and the SCR are too close to each other, the chance of breaching the MCR in a group at the same moment as the SCR can be rather high. We think that this is an unwanted effect.

We hope that the above comments are of assistance to CEIOPS, and we look forward to continuing our productive dialogue with CEIOPS.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Bart De Smet', with a stylized, cursive script.

Bart De Smet

Chairman, Insurance Committee